

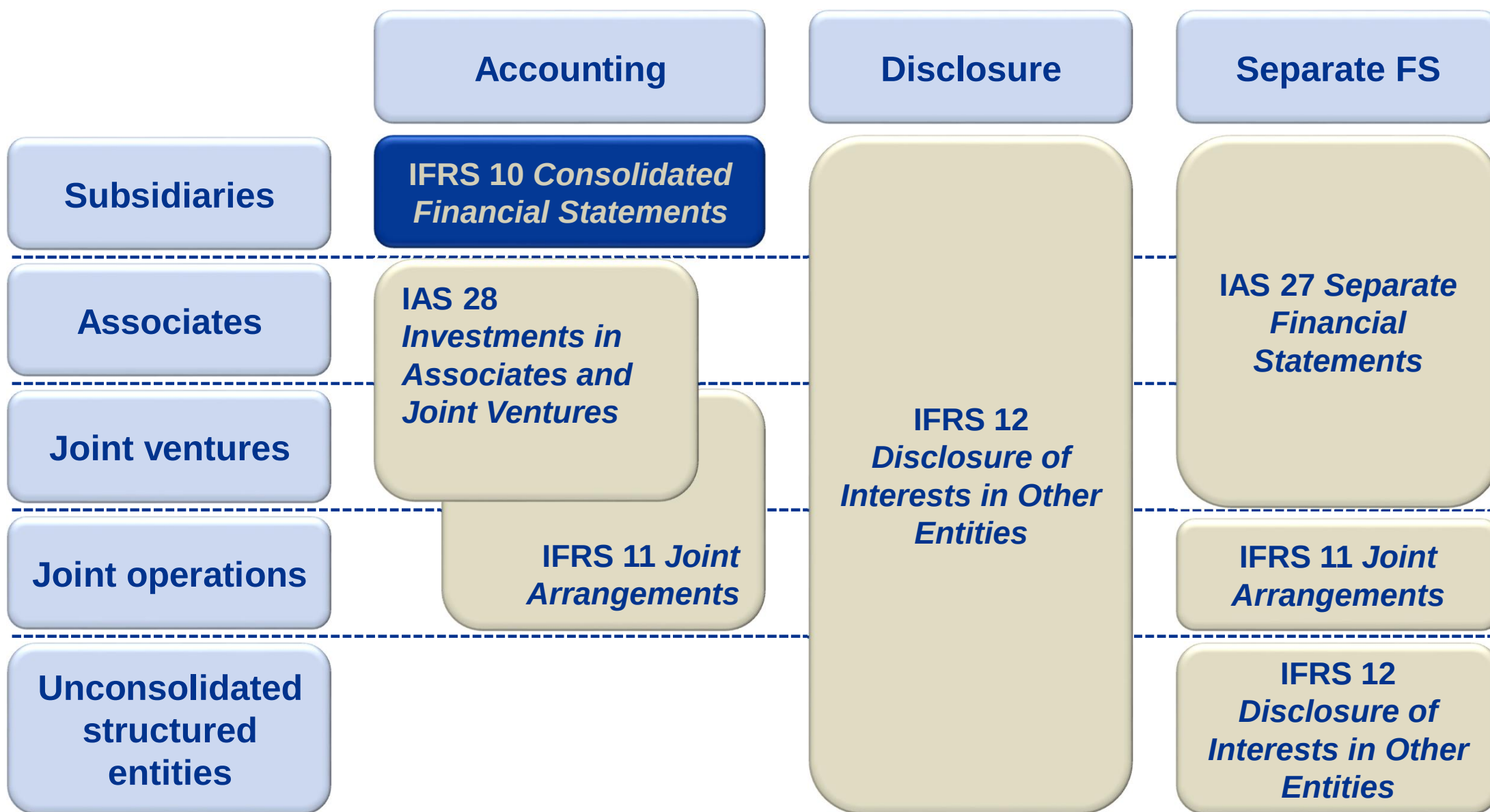
IND AS 110

Consolidated Financial Statements

Disclaimer

“The material/presentation is prepared for use in educational programmes conducted by the Institute of Chartered Accountants of India. The views expressed herein do not necessarily represent the views of the Council of the Institute or any of its Committees.”

A new suite of consolidation standards

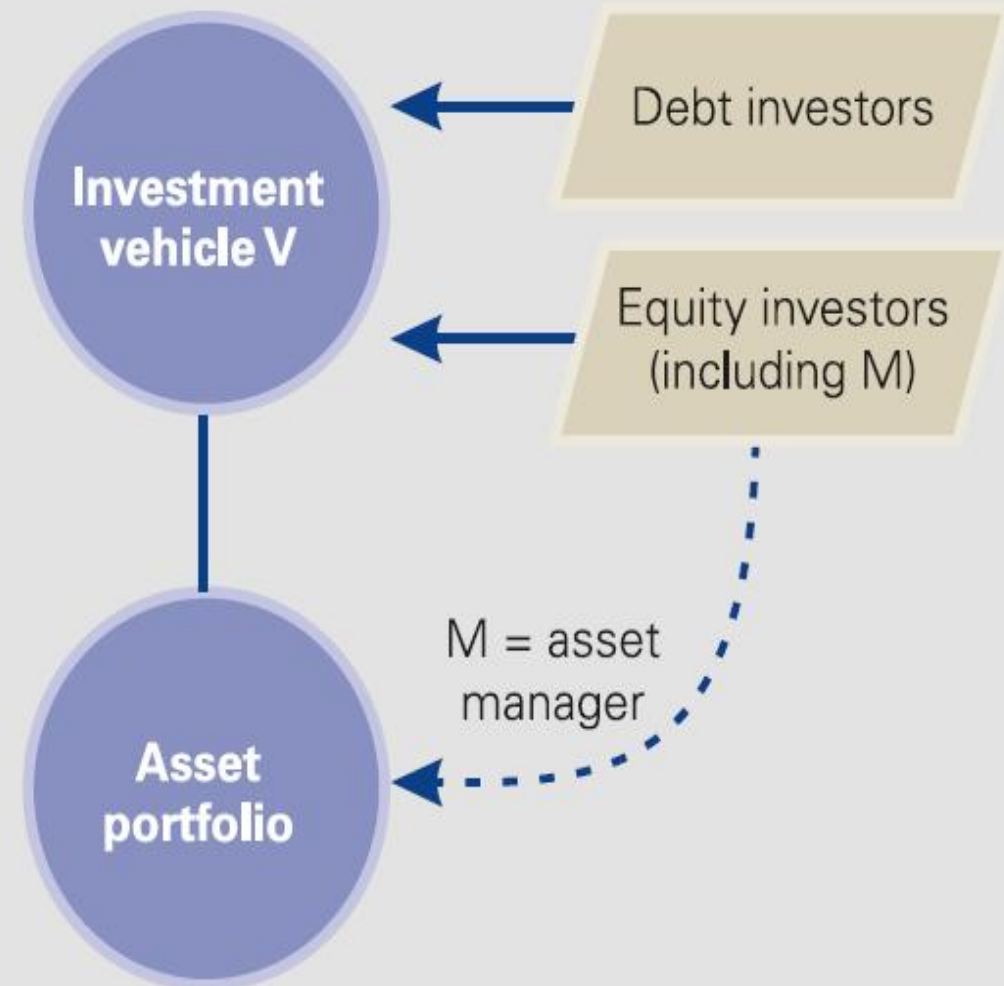


Example- Structured entity

Example 1

Investment vehicle V is created to purchase a portfolio of financial assets, funded by debt and equity instruments issued to a number of investors.

Investor M holds 30 percent of the equity and is also the asset manager managing V's asset portfolio within portfolio guidelines. This management includes decisions about the selection, acquisition and disposal of the assets within those portfolio guidelines and the management upon default of any asset in the portfolio.



1. Introduction

2. The new control model

SCOPE

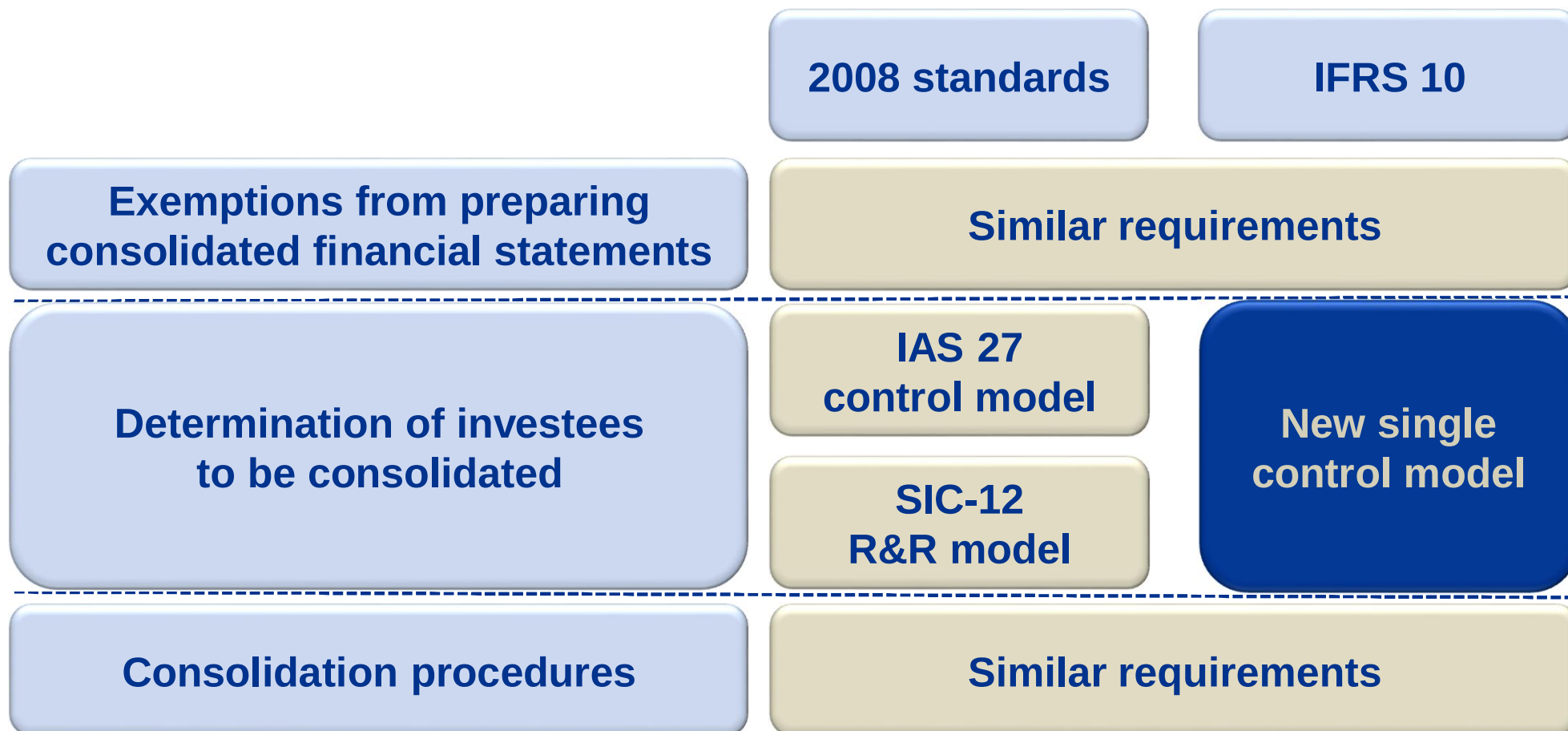
General Requirement

An entity that is a parent shall present CFS

Parent entities are exempted from having to consolidate if:

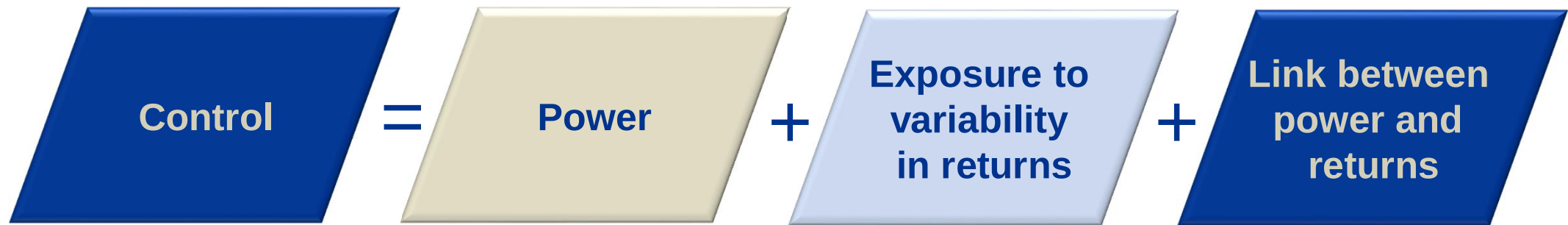
- a. The parent is a wholly or partially owned subsidiary in which all owners do not object to non-consolidation.
- b. Its debt or equity instruments are not publicly traded
- c. It is not in the process of listing its debt or equity
- d. The ultimate or any intermediate parent of the parent entity produces Ind-AS consolidated financial statements that are available for public use.

From IAS 27/SIC-12 to IFRS 10



R&R = risks and rewards

IFRS 10 in a nutshell



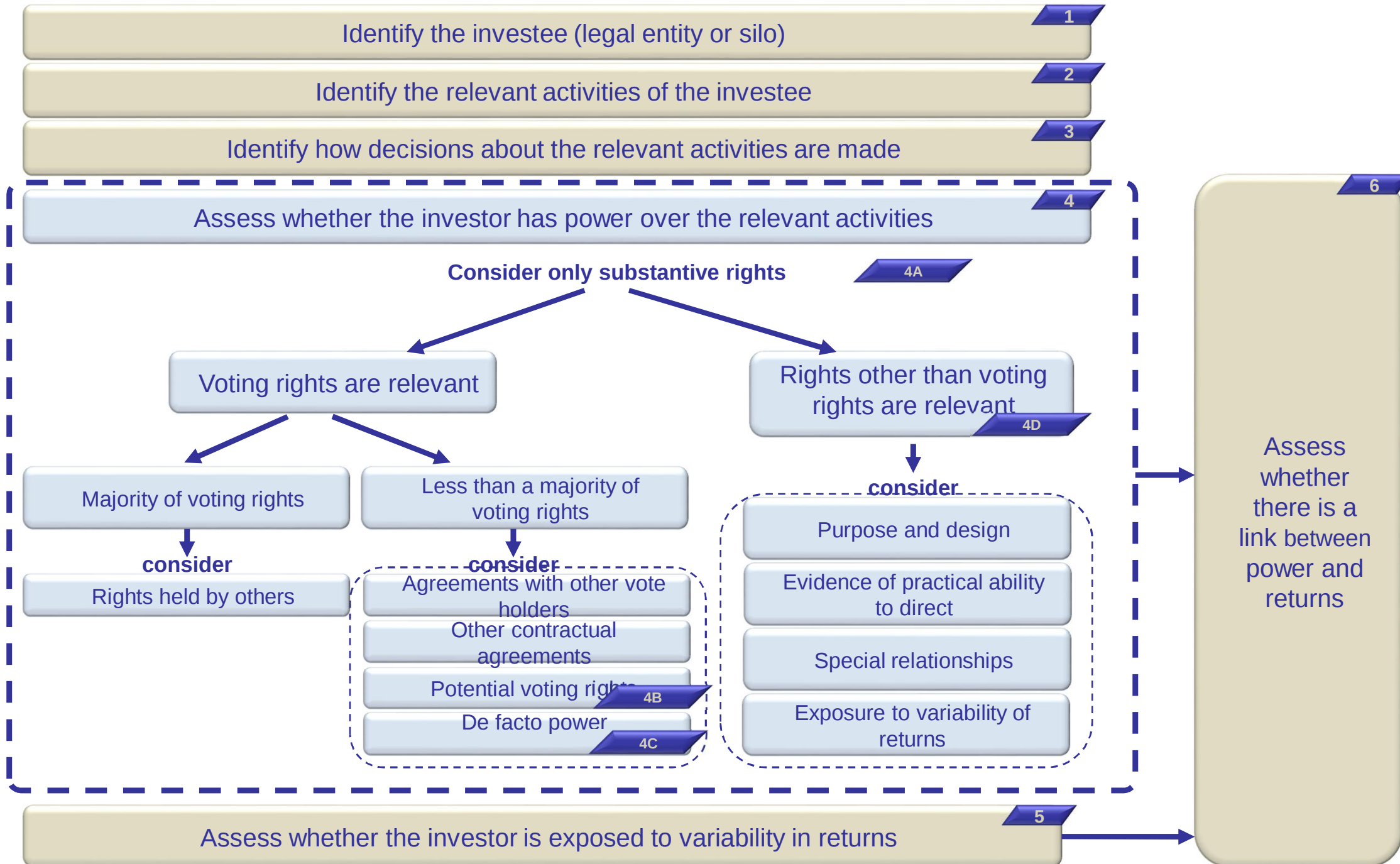
To have power, it is necessary for investor to have existing rights that give it ***current ability*** to direct the activities that significantly affect the investee's returns, i.e. the ***relevant activities***

Control assessed on continuous basis

1. Introduction

2. The new control model

Simplified presentation of the new single control model



The new single control model

- 1 Identify the investee (legal entity or silo)
- 2 Identify the relevant activities of the investee
- 3 Identify how decisions about the relevant activities are made
- 4 Assess whether the investor has power over the relevant activities
- 5 Assess whether the investor is exposed to variability in returns
- 6 Assess whether there is a link between power and returns

Identify investee (legal entity or silo)

1

Control by investor generally assessed at entity level,
but also can be assessed over only specified assets and liabilities (a silo)

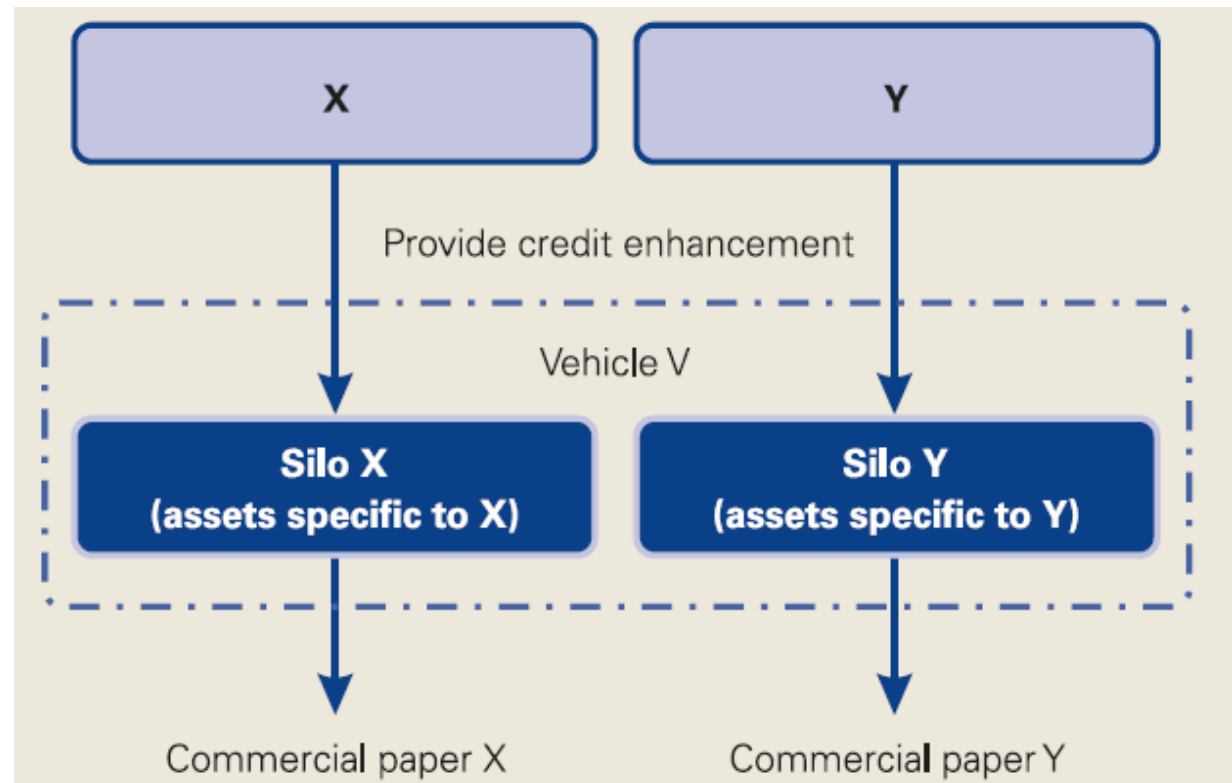
Silo = portion
of an entity
treated as a
deemed
separate
entity

- ◆ In substance, assets, liabilities and equity are separate from overall investee such that none of the assets can be used to pay other obligations of the entity and they are the only source of payment for specified liabilities of the silo
- ◆ Parties other than those with the specified liability have no rights or obligations related to the specified assets or to the residual cash flows of those assets

Identify investee (legal entity or silo)

1

- ◆ Two companies X and Y, transfer trade receivable and credit enhancements to vehicle V, which issues commercial papers, thereby acting as the referencing vehicle for X and Y. There is no cross collateralisation of the transferred assets.



- ◆ Because there is no cross collateralisation, each originator, X and Y, assesses whether it controls its specific silo, which includes the receivables transferred as financial assets and its specified commercial paper liability.

Identify relevant activities of investee

2

Relevant activities = activities that *significantly* affect the investee's returns

A range of operating and financing activities significantly affects returns
(eg. Sale of goods, management of financial assets, management of R&D activities etc.)

There are different relevant activities (which can occur at different times)

Relevant activities occur only when particular circumstances or events occur (direction of activities predetermined until this date)

Determine which of these activities **most** significantly affects returns

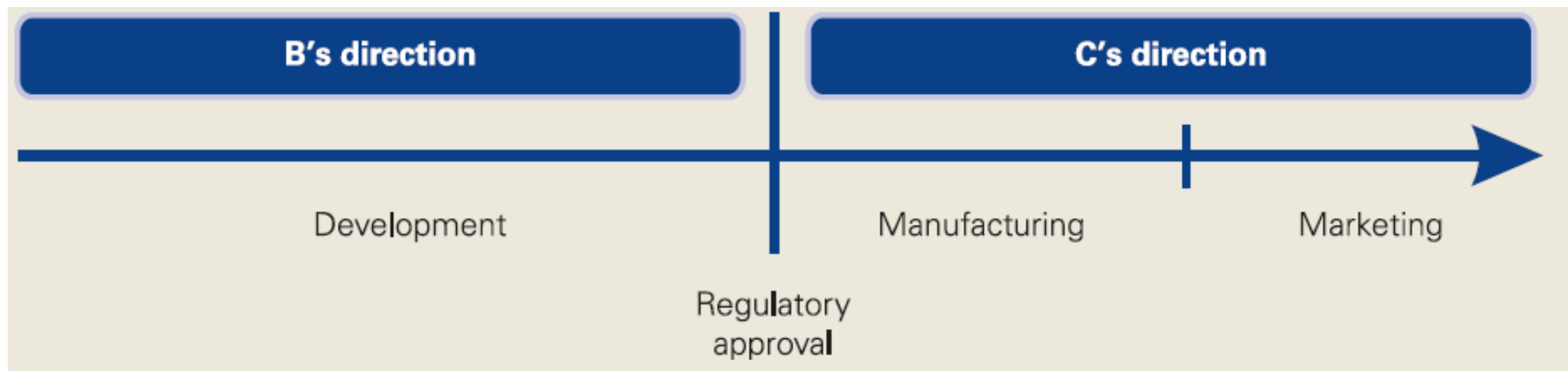
Appointing, terminating KMPs

Assessment of power made at **this activity's** level

Only decisions **when those events occur** relevant for assessment of power

Example- Identification of relevant activities

- ◆ Two companies B and C, form an investee that is engaged in development of medical product and intends to manufacture and market the product subsequent to its development.
- ◆ B has the unilateral ability to make decision related to development, and C has the unilateral ability to make decision about manufacturing and market. All of the activities are relevant activities.



Example- Identification of relevant activities

◆ Which activity most significantly affect returns?

◆ **General considerations:**

- a) the purpose and design of the investee;
- b) the factors that determine the profit margin, revenue and value of the investee as well as the value of the medical product;
- c) the effect on the investee's returns resulting from each investor's decision-making authority with respect to the factors in (b); and
- d) the investors' exposure to variability of returns.

◆ **Considerations specific to this example:**

- e) the uncertainty of, and effort required in, obtaining regulatory approval (considering the investor's record of successfully developing and obtaining regulatory approval of medical products); and
 - f) which investor controls the medical product once the development phase is successful.
-

Example- Identification of relevant activities

- ◆ The only assets of an investee are receivables and the only relevant activity is managing the receivables upon default.
 - ◆ The fact that this activity only arises in the event of a default is not taken into account in assessing control; and probability of default is not considered in this analysis because this is only decision that can affect the return significantly.
 - ◆ Therefore, the investor with the power over the activity has control even prior to default.
-

Identify how decisions about relevant activities are made

3

Are voting rights relevant in assessing whether investor has power over investee?

**Gating
question**

Investee controlled by
means of voting rights

More complex cases

Investees designed so that
voting rights not relevant
(generally structured
entities)

Focus on which investor
has voting rights sufficient
to direct investee's
relevant activities

Number of factors
relevant to assess what is
determinative

Focus on rights other than
voting rights

Gating question- Continuous assessment

- ◆ Company S is set up as an entity controlled by means of equity instruments. Company L holds 60 per cent of the voting right in S, and Company M and N, each hold 20 per cent. There are no arrangements, that alter decision making in S, and it is concluded that L controls S.
 - ◆ During the first year of activity, S incurs significant unexpected losses so that its net assets become negative. M agree to provide significant financing to S to continue development of its activities and in return obtain the right to appoint some of the key management personnel who direct the relevant activities of S as well as the right to approve budgets in the ordinary course of business.
 - ◆ In this example, it could be determined that S has become an entity in which voting rights are not relevant.
-

Only substantive rights considered

4A

Substantive rights

The rights are exercisable **when decisions about the relevant activities of an investee need to be made...**

...and their holder has a **practical ability to exercise** the rights

Factors to consider:

Are there barriers that prevent holder from exercising the rights?

Would party holding the rights benefit from their exercise?

Do several parties need to agree for the rights to become exercisable or operational?

Rights.....whether substantive?

- § Rights in the form of voting rights (or potential voting rights) of an investee;
 - § Rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;
 - § Rights to appoint or remove another entity that directs the relevant activities
 - § Rights to direct the investee to enter into, or veto any change to, transaction for the benefit of investor;
-

Is there the practical ability to exercise?

Are there barriers to exercise of those rights by holder?

§ Examples:

- § Financial penalties
 - § High exercise or conversion price
 - § Narrow exercise periods
 - § Absence of a mechanism to exercise
 - § Lack of information to exercise
 - § Lack of other parties willing or able to take over
 - § Legal or regulatory barriers
-

Is there the practical ability to exercise?

- § Do practical mechanisms exist for collective exercise of rights, when exercise required by more than one investor?
- § The more parties that need to agree, the less likely that the rights are substantive.
- § A mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so

For example- An independent board of directors may serve as a mechanism for numerous investors to act collectively in exercising their rights

- § Will the holder benefit from the exercise of those rights?
 - § Potential voting rights are more likely to be substantive if: they are in the money; or
 - § the investor will benefit for other reasons from exercise (for example, realise synergies)
-

Protective Rights

- § Protective rights are designed to protect the interest of their holder, but do not give that party power over the investee.
 - § Protective rights give the holder protection in exceptional circumstances or prevent fundamental changes from being made to the activities of the investee.
 - § Examples of *protective rights include*:
 - a. A lender's right to restrict the borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.
 - b. The right of a lender to seize assets of a borrower if the borrower fail to meet specified loan repayment conditions.
 - c. Approve an investee's capital expenditures (greater than the amount spent in the ordinary course of business)
-

Franchises

A franchisor may have certain rights that are designed to protect its brand when it is being licensed by a franchisee. Activities that significantly affect the franchises returns may include;

- § Determining or changing its operating policies
 - § Setting its prices for selling goods
 - § Selecting suppliers
 - § Purchasing goods and services
 - § Selecting, acquiring or disposing of equipment
 - § Appointing, remunerating or terminating the employment of key management personnel
-

Voting rights are relevant

4

Majority of voting rights

consider:

Rights held by others

- Ø Voting rights not substantive
- Ø No ability to direct relevant activity.
- Ø Another party directs relevant entity

Less than a majority of voting rights

consider:

Agreements with other vote holders

Other contractual agreements

Potential voting rights

4B

De facto power

4C

Example- Less than majority voting rights

Agreement with other vote holders

- § Company E owns 40 per cent of voting power in Company G, and Company F owns the other 60 per cent. F therefore, appears to have power over G.
- § However, F has entered into an agreement with E such that F defers to the wishes of E in respect of voting. F has done this because it has no expertise in this area of G's operation.
- § Therefore, in accordance with this agreement, E has power over G.

Rights arising from other contractual arrangements

- § The rights can have power without a majority of the voting right of an investee, for example- the rights within the arrangement in combination with its voting rights give it the current ability to direct some of the processes of an investee that significantly affect the investee's return.
-

Potential voting rights

4B

Potential voting rights considered only if **substantive**

Purpose and design also considered



- ◆ Option to acquire majority of voting shares in C exercisable in 25 days and deeply in the money
- ◆ Next shareholder meeting, at which decisions to direct the relevant activities are made, is in 8 months.
- ◆ Special meeting to change existing policies over relevant activities can be called at any time with 30 days' notice

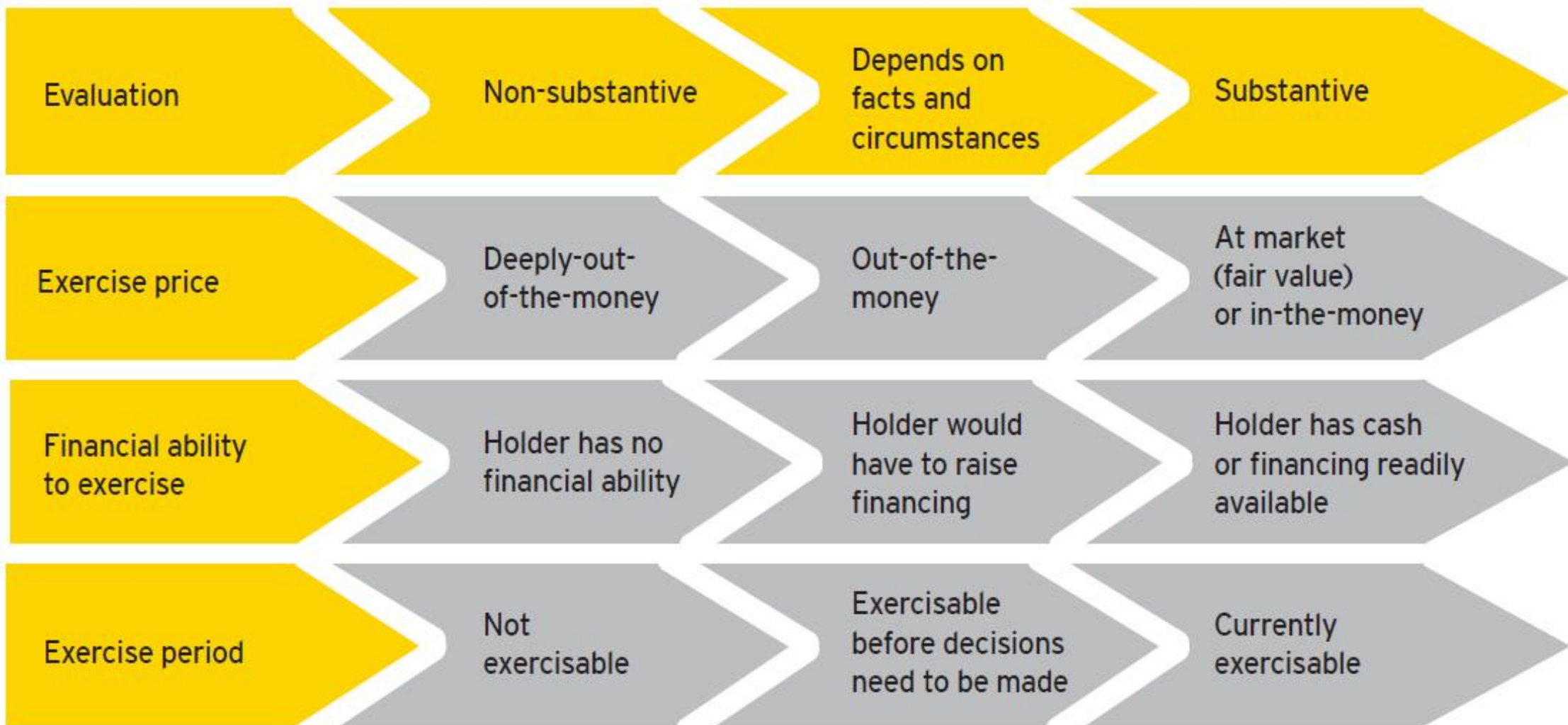
B is likely to control C: its rights are essentially equivalent to those of ordinary shareholders in C

Substantive right- Yes or No

Fact pattern	Financial position of potential voting right	Other facts	Conclusion
30% investor with call option exercisable over next 2 years for a further 50%.	Deeply out of the money and expected to remain so over option life.	The other investor (holding 70%) has been exercising its votes and actively directing the investee's activities.	
Three investors each hold 1/3 of votes in an investee. One investor (A) holds convertible debt with a fixed strike price. If converted, A will own 60% of votes	Out of the money but not deeply out of the money	- Investee's business activity is closely related to A. - A benefits from synergies if the conversion option is exercised.	

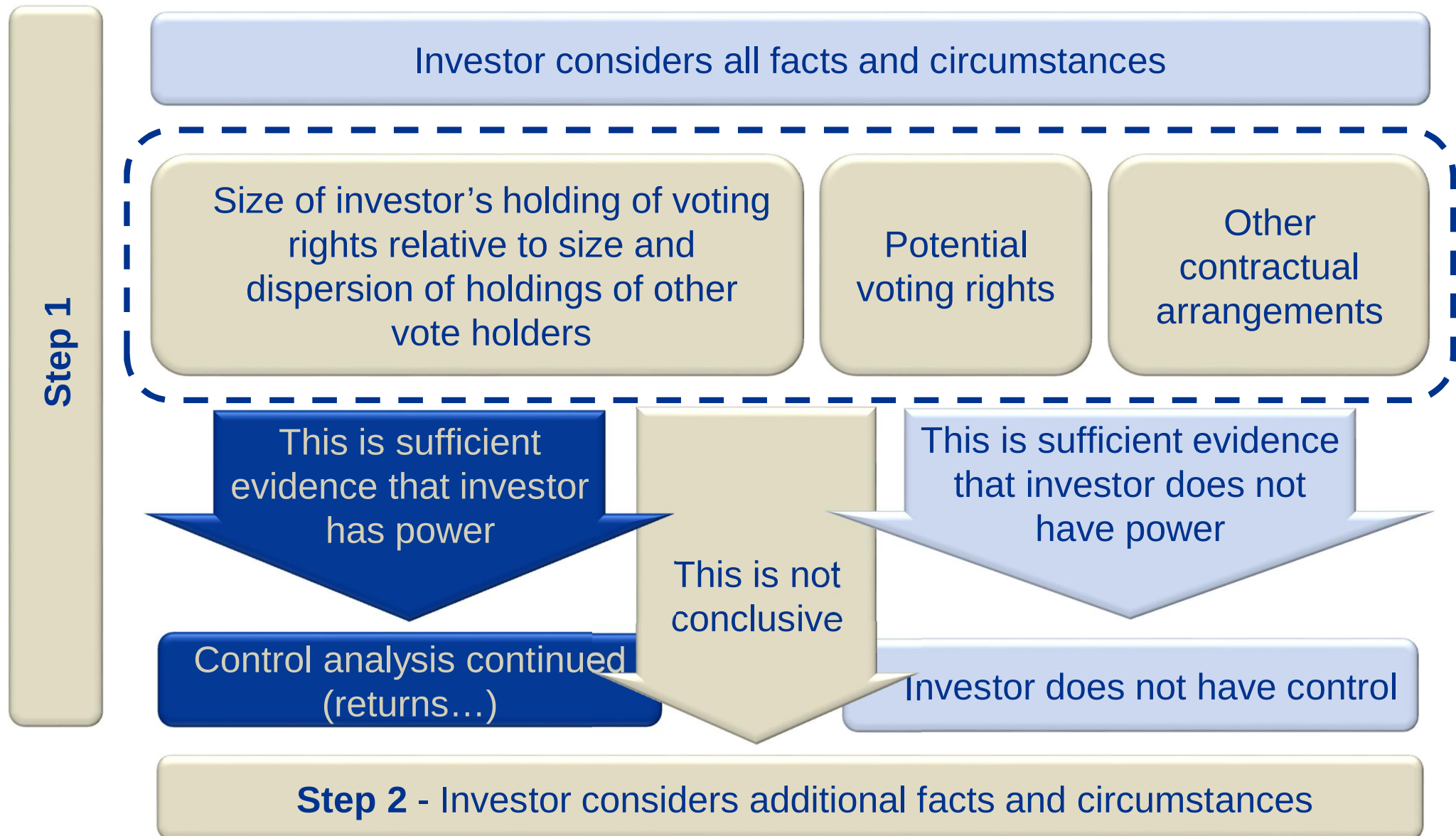
Potential voting rights

4B



Assess whether investor has *de facto* power over investee (1)

4C



Assess whether investor has *de facto* power over investee (2)

4C

These factors may be sufficient evidence of power

- ◆ Investor holds 48% of investee
- ◆ Remaining voting rights held by thousands of shareholders, none > 1%

ü

These factors may be sufficient evidence that the investor does not have power

- ◆ Investor holds 45% of investee
- ◆ Two other investors hold 26% of the voting rights
- ◆ No other arrangements that affect decision-making

x

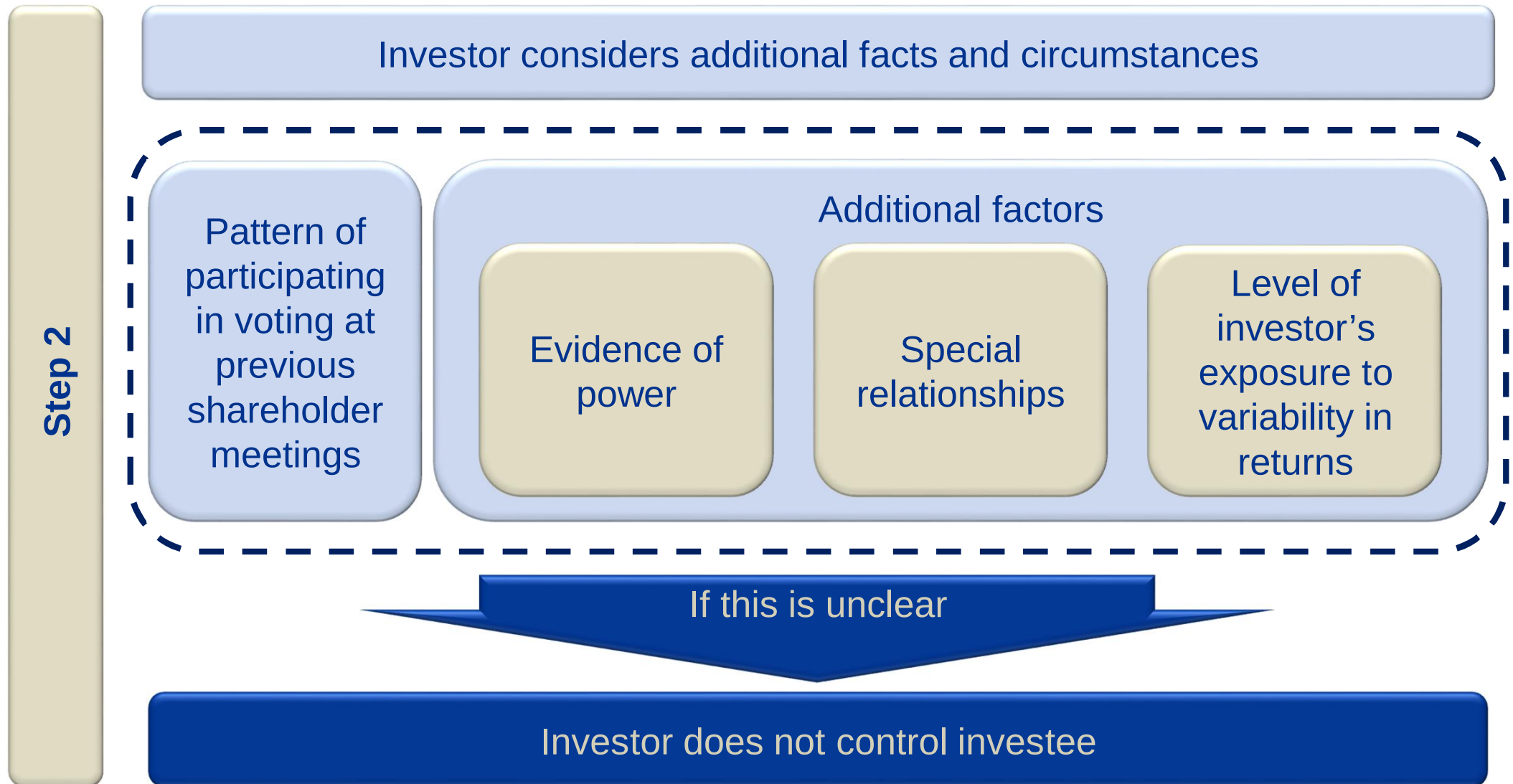
These factors may not be conclusive – step 2 analysis required

- ◆ Investor holds 35% of investee
- ◆ Three other investors each hold 8% of voting rights
- ◆ Remaining 41% widely dispersed
- ◆ No other arrangements that affect decision-making

?

Assess whether investor has *de facto* power over investee (3)

4C



Assess whether investor has *de facto* power over investee (4)

4C

Step 1
not
conclusive

- ◆ Investor holds 35% of investee
- ◆ Three other investors each hold 8% of voting rights
- ◆ Remaining 41% widely dispersed
- ◆ No other arrangements that affect decision-making

- ◆ Decisions about relevant activities require approval of majority of votes
 - ◆ At recent shareholder meetings, 75% of voting rights cast
 - ◆ That is, P holds only 47% (35/75) of active voting rights

Additional factors

Other factors might also indicate that an investor has power over an investee. For example, IFRS 10 states that this might be the case when the investee:

- Ø Is directed by key management personnel who are current or previous employees of the investor
- Ø Has significant
 - § Obligations that are guaranteed by the investor
 - § Activities that either involve or are conducted on behalf of the investor
- Ø Depends on the investor for:
 - § Funding a significant portion of the operation
 - § Licenses, trademarks, services, technology, supplies or raw materials that are critical to the licensee's operations
 - § Key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations

Rights other than voting rights are relevant

4D

Purpose and design

Involvement, decisions, contractual arrangements at investee's inception

Circumstances in which relevant activities occur

Commitment to ensure that investee continues to operate as designed

Other factors to consider

Evidence of practical ability to direct, e.g. investor can appoint or approve investee's key management personnel who direct relevant activities

Special relationships, e.g. significant portion of investee's activities either involve or conducted on behalf of investor

Large exposure to variability in returns

Greater weight given to evidence of practical ability to direct

Is investor exposed to or has rights to variable returns?

5

Distributions and changes in value of investment in investee

Fees, exposure to loss from providing credit or liquidity support, residual interest in the net assets, tax benefits etc

Returns vary as a result of performance of investee and can be only positive, only negative, or positive and negative

Returns that are not available to other interest holders, such as investor's ability to use investee's assets in combination with its own to achieve economies of scale

Is investor exposed to or has rights to variable returns?

- § IFRS 10 gives the example of an investor that holds a **bond with fixed interest payments**. The fixed interest payments are considered an exposure to variable returns, because they expose the investor to the credit risk of the issuer. How variable those returns are depends on the credit risk of the bond.
 - § Similarly, IFRS 10 also explains that **fixed performance fees** earned for managing an investee's assets are considered an exposure to variable returns, because they expose the investor to the performance risk of the investee. That is, the amount of variability depends on the investee's ability to generate sufficient income to pay the fee.
 - § In contrast, a **non-refundable fee received up-front** (wherein the investor does not have exposure to credit risk or performance risk) would likely to be considered a fixed return.
-

Assess whether there is a link between power and returns

6

Power

+

**Exposure to
variability
in returns**

+

**Use of the power
to generate
returns for itself**

=

**The investor
is a principal**

Power

+

**Exposure to
variability
in returns**

+

**Use of the
delegated power
for the benefit of
others**

=

**The investor
is an agent**

Is investor a principal or an agent? (1)

6

Does a single party hold substantive rights to remove the decision maker without cause?

no

Is the remuneration 'at market', i.e.

- ♦ is it commensurate with services provided; and
- ♦ does it include only terms, conditions, amounts customarily present in arrangements for similar services and level of skills on arm's length basis?

yes

Continue the analysis

...

no

Investor is
a principal

yes

Investor is
an agent

Is investor a principal or an agent? (2)

6

Consider the 4 indicator groups

Scope of decision-making
authority

Rights held by other parties

(“Economic interests” aggregated)

Remuneration

Other interests held

Investor is a principal
Power belongs to decision maker

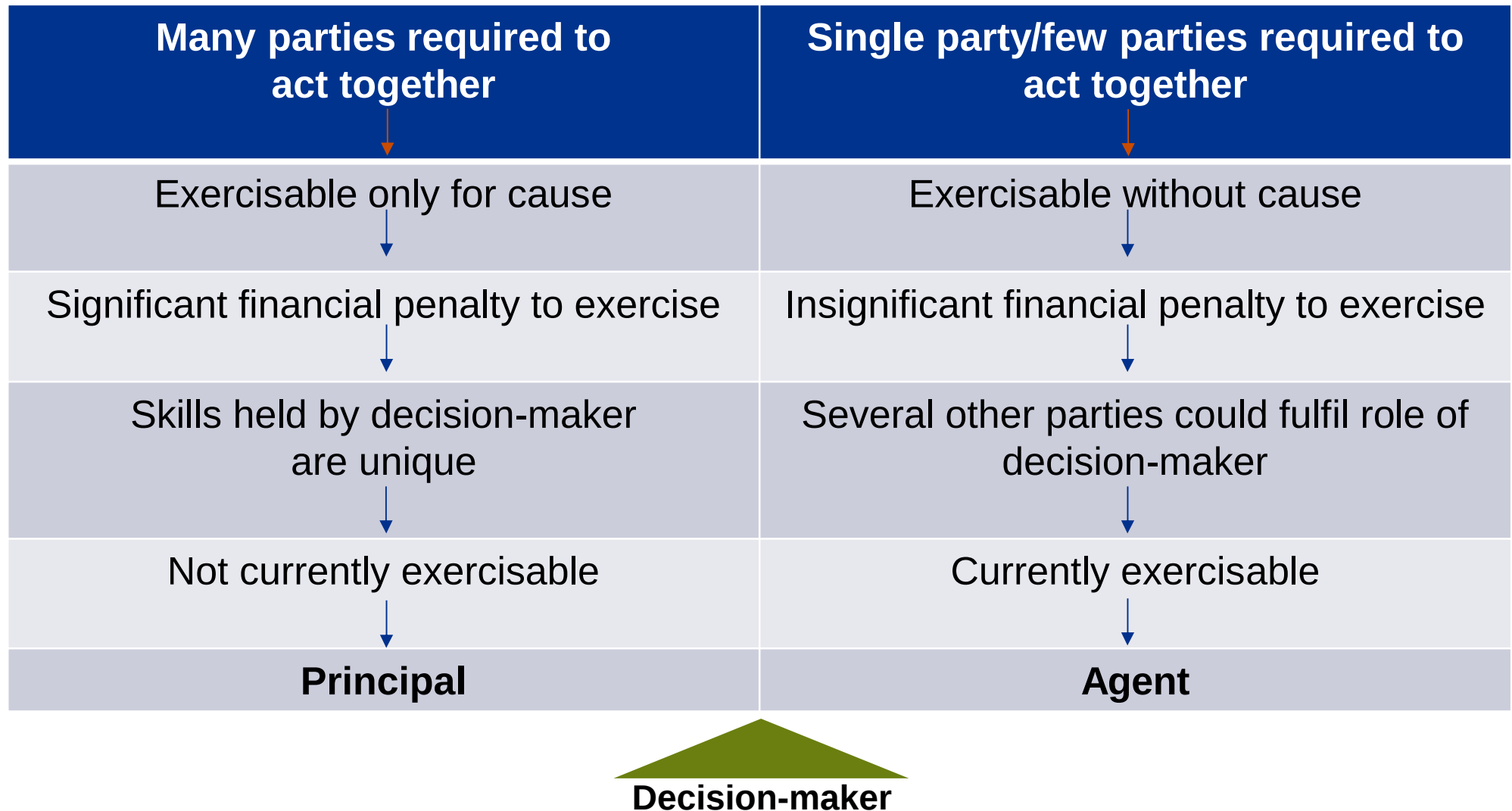
Investor is an agent
Power is delegated to decision maker

Scope of decision making authority

- ◆ The investor (decision- maker) consider the following-
 - ◆ The activities that are permitted according the decision- making agreement and specified by law and
 - ◆ Its level of discretion
-

Rights held by other parties (cont'd.)

Evaluating whether removal rights are substantive



Remuneration

§ To be an agent, remuneration must :

- Be commensurate with services provided AND
- Includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated on an arm's length basis

Commensurate	“Market” terms	Conclusion
a	a	More likely agent
a	x	More likely principal
x	a	More likely principal
x	x	More likely principal

Exposure to variability through other interest

- § If decision maker holds other interests in an investee, may indicate he is principal.
 - § Other interest can be – investment in the investee or guarantee provided in respect of performance of investee.
-

Analysis of the examples in IFRS 10

Example	Scope of decision making rights	Removal rights	Remuneration	Other interests	Conclusion
13	Narrowly defined parameters	None	1% of net asset value	10% direct interest	
14A	Wide ranging discretion	Removal for cause	1% of net asset value and 20% of profits after a hurdle is reached	2% direct interest	
14B	Wide ranging discretion	Removal for cause	1% of net asset value and 20% of profits after a hurdle is reached	20% direct interest	
14C	Wide ranging discretion	Removal without cause by independent board	1% of net asset value and 20% of profits after a hurdle is reached	20% direct interest	
15	Narrow discretion	Removal without cause by widely dispersed investors	1% of net asset value and 10% of profits after a hurdle is reached	35% direct interest	

The overall evaluation of whether a decision maker is acting in the capacity of principal or an agent is primarily a qualitative evaluation requiring the use of **judgement**.

Relationships with other parties

Investor considers whether other parties act on its behalf, i.e. as its *de facto* agents



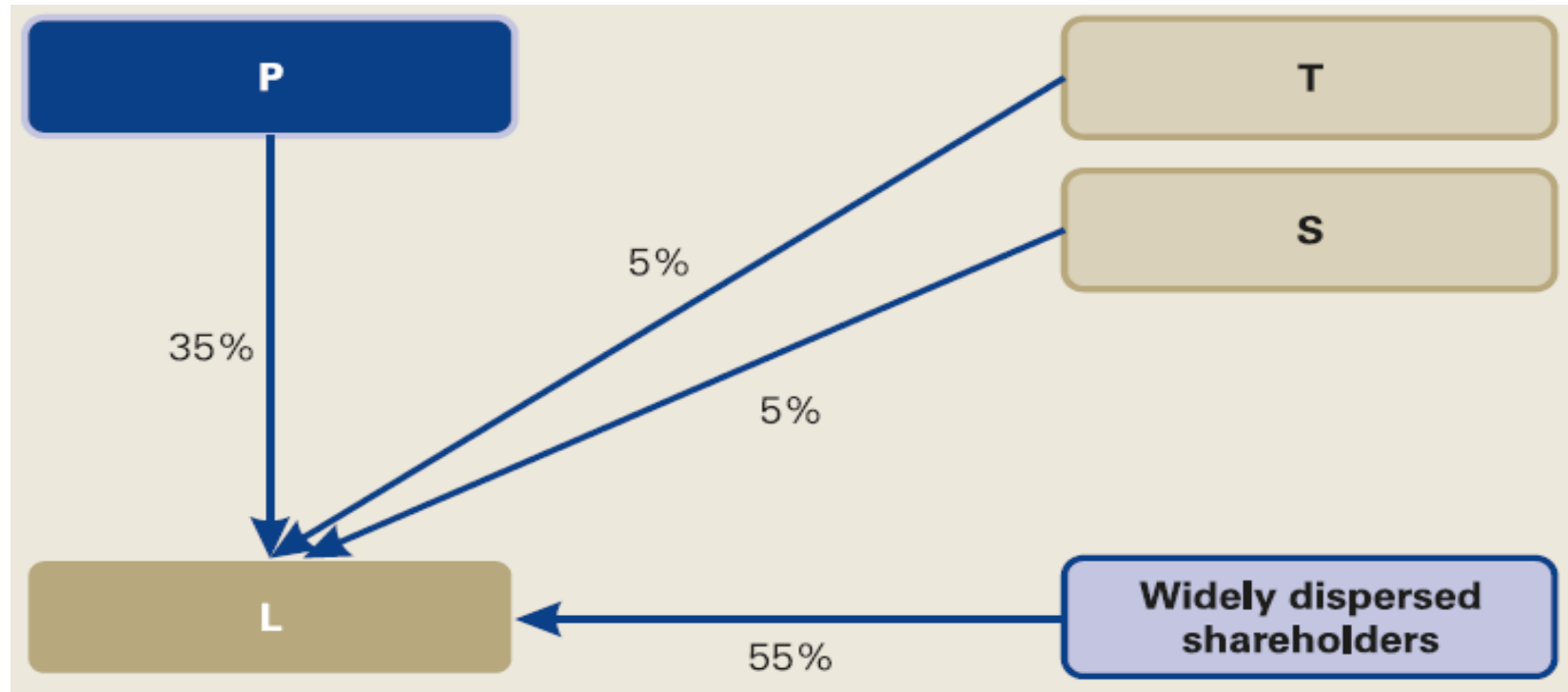
Decision-making rights delegated to an agent are treated as held by investor directly

Examples of entities that may be acting as *de facto* agents:

- ◆ Related parties of investor
- ◆ Party that has a close business relationship with investor
- ◆ Party whose governing body / key management personnel is almost the same as investor's
- ◆ Party that received its interest in investee as contribution or loan from investor
- ◆ Party that cannot finance its operations without subordinated support from investor
- ◆ Party that has agreed not to sell, transfer or encumber its interest in the investee without investor's prior approval

Example

§ The voting interest in Company L, listed company are as follows



- § No shareholder other than P, T, S has more than 1 per cent share.
- § There is no contract b/w P, T, S on how to vote.
- § However, T and S always vote as P since they both have business relation with P.

Example

- § P should first consider whether T and S are acting as de-facto agents on behalf of P.
 - § If so, P would have 45 per cent voting rights and P should consider whether it has de-facto control over L.
 - § If P concludes that T and S are not de-facto agents, then P would still need to assess whether it has de-facto control over L but assessment would be based on P holding 35 per cent.
-

Investment entities

Overview

- § 'Investment entity' is now defined in IFRS 10
 - § An investment entity **does not consolidate subsidiaries** unless they provide investment-related services
 - § An investment entity **measures its subsidiaries at fair value through profit or loss** in accordance with IFRS 9 *Financial Instruments*
 - § An entity must consider all facts and circumstances, including purpose and design, to make the assessment
-

Investment entities

Definition

- § An investment entity is an entity that:
- **Obtains funds from one or more investors** for the purpose of providing those investors with professional investment management services
 - Commits to its investors that its **business purpose is to invest funds solely for returns** from capital appreciation, investment income or both

And

- **Measures and evaluates** the performance of substantially all of its **investments on a fair value basis**

Investment entities

Typical characteristics

Factors to consider alongside the definition:

- The entity has **more than one investment** – to diversify the risk portfolio and maximise returns
 - The entity has **more than one investor** – to pool funds to maximise investment opportunities
 - Investors in the entity **are not related parties** of the entity
-

Investment entities

Reassessment of status

§ If there are changes to:

- One or more of the three elements of the definition of an investment entity

Or

- The typical characteristics of an investment entity

Then the entity must reassess whether it is an investment entity

§ Any change in investment entity status must be accounted for **prospectively** from the date of change

Investment entities

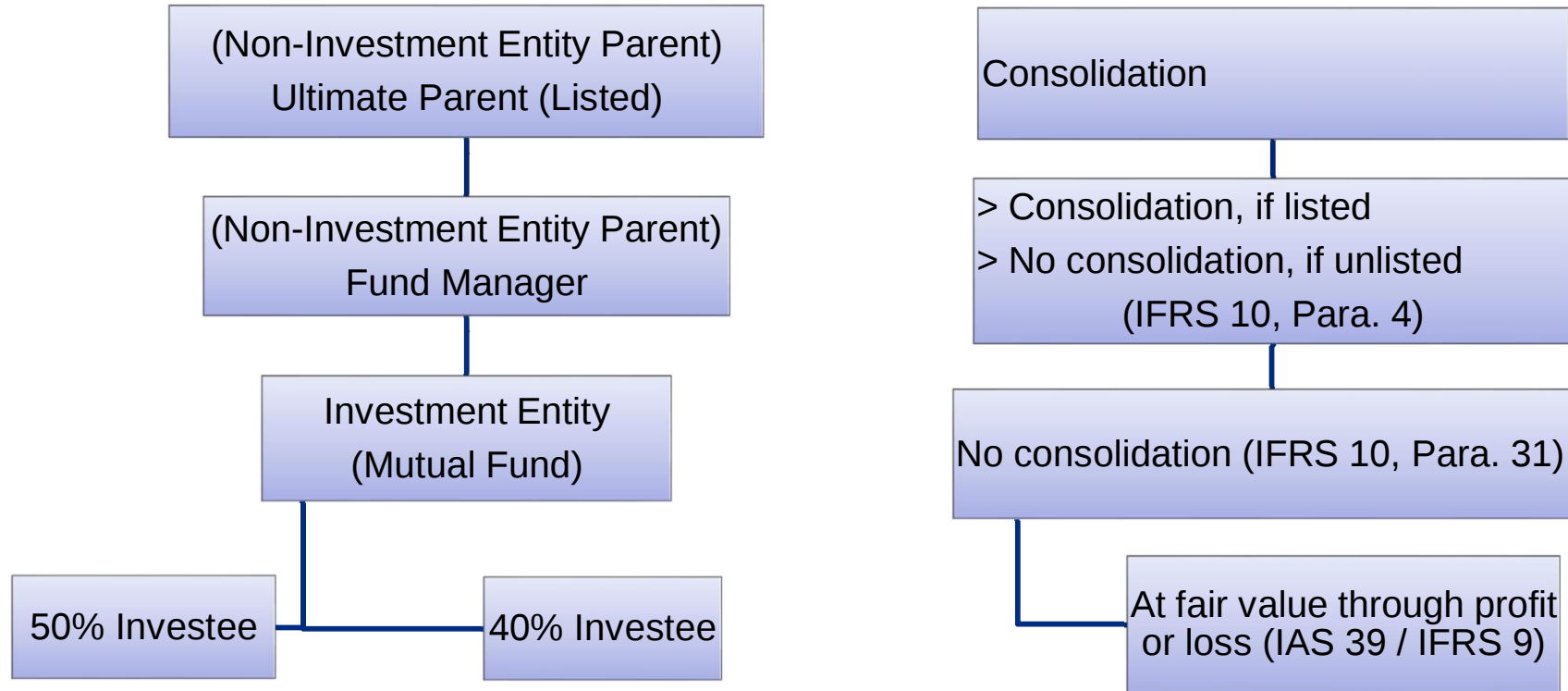
Parent of an investment entity

Non-investment entity parent of an investment entity

- The exception to consolidation is not retained by the parent entity if it is not an investment entity itself
 - Instead, **the parent must consolidate all its subsidiaries**
-

Investment entities

Conclusion



Accounting Requirements

Accounting requirements

- § Accounting policies- A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.
- § Date of consolidation- 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.
- § Reporting date- The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date. If not, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements adjusted for the effects of significant transactions or events. In any case, the difference between the two financial statements shall be no more than three months,

Non- controlling interest

- § 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 balance.
 - § A parent shall present non-controlling interests in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.
 - § Difference arising on any change in proportion of NCI shall be recorded directly in equity (not income statement).
-

Loss of control

- § If a parent loses control, it shall
 - Derecognize-
 - Subsidiary's net assets (including goodwill)
 - Non- controlling interest
 - Recognize-
 - fair value of consideration received.
 - Any retained investment at fair value on such date
 - Resulting difference, if any – takes to profit or loss.
-

Loss of control

§ Example-

ABC Limited holds 60% (6 million) share in XYZ Limited. On 31 December 2015, carrying value of identifiable net assets of subsidiary was Rs.120 million. On that date, ABC sold 0.5 million shares of subsidiary for Rs.10 million.

Show the required journal entry in consolidated financial statement of ABC Limited.

§ Analysis-

Bank A/c	Dr.	10 million
To NCI	Cr.	6 million
To Equity	Cr.	4 million

Loss of control

§ Working-

Carrying value of identifiable net assets	120 million
Total number of outstanding shares	10 million
Book value of 50,000 shares sold- (120 million/ 10 million* 0.5 million)	6 million
Value at which shares were sold	10 million
Difference to be booked in equity	4 million

Loss of control

§ Example-

ABC holds 80% shares in XYZ Limited. Carrying value of net assets of XYZ Limited on 31 December 2015 is 100 million. Carrying amount of Goodwill and Non controlling interest on same date is 10 million and 20 million respectively.

On 31 December 2015, ABC sold 65% of shares in XYZ for 70 million. On the same date, fair value of balance investment is 30 million.

Show the accounting entry to be passed-

Loss of control

§ Journal entry-

Bank	Dr.	70 million
NCI	Dr.	20 million
Investment	Dr.	30 million
Net Assets	Cr.	100 million
Goodwill	Cr.	10 million
Income statement (Balancing figure)	Cr.	10 million

Non- controlling interest

- § A has a 40% interest in Z, whose relevant activities are directed by voting shares that entitle the holder to a pro rata share of returns of Z. Based on the facts and circumstances,
 - § A concludes that, by itself, its 40% interest does not give A control over Z.
 - § B holds a 15% interest in Z.
 - § A evaluates the facts and circumstances and concludes that B is a de facto agent of A.
 - § Based on the combined interest, A concludes that it controls Z, because it can direct B how to vote by virtue of being a de facto agent. Accordingly, A consolidates Z in its consolidated financial statements and reflects a non controlling interest in B of 60% (i.e., all interests not held by A).
-

Inter company trading

- § Inter-company balances are cancelled on consolidation
- § If a group company sells inventory to another group company and that inventory is still held by the buying company at the year end:
 - the selling company will show profit in its own accounts

But, this profit is not realised from the group's perspective

- the buying company will record the inventory at cost to itself.

But consolidation of this value will result in the inclusion in the financial statements of a figure which is not at cost to the group.

Intra-group trading

- § Intragroup balances, transactions, income and expenses are eliminated in full
- Sales/cost of sales
 - Administration charges
 - Management fees
 - Unrealised profits
 - Dividends receivable and payable
 - Trade and other receivables/payables
 - Current accounts.
-

Unrealised profit – IFRS 10

- § “... resulting unrealised profits should be eliminated in full”
 - § This implies that unrealised profit should be eliminated from the inventory value
-