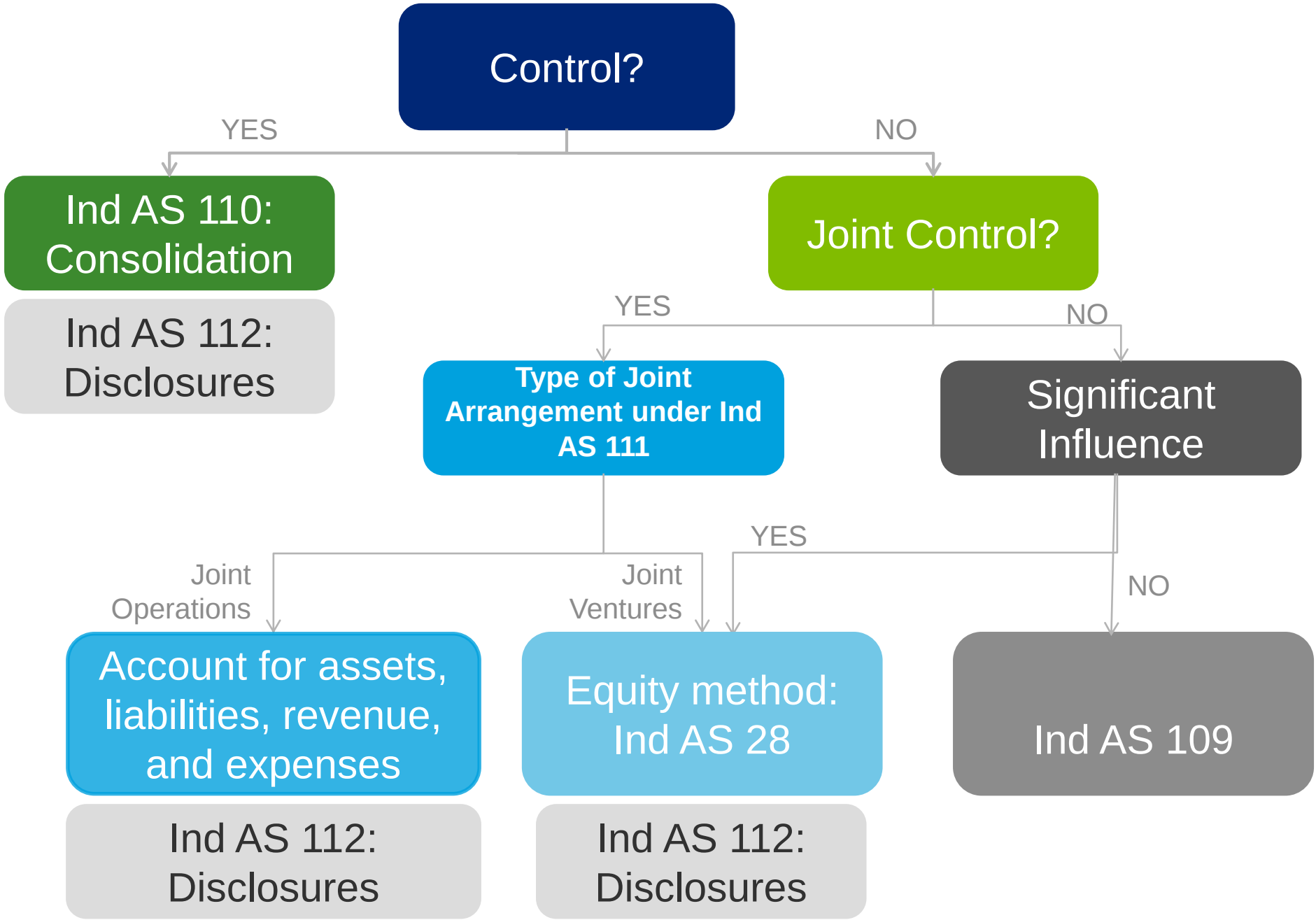


Interaction between Ind AS 110, 111, 112 and other Ind AS



Fundamental principle

Ind AS 110

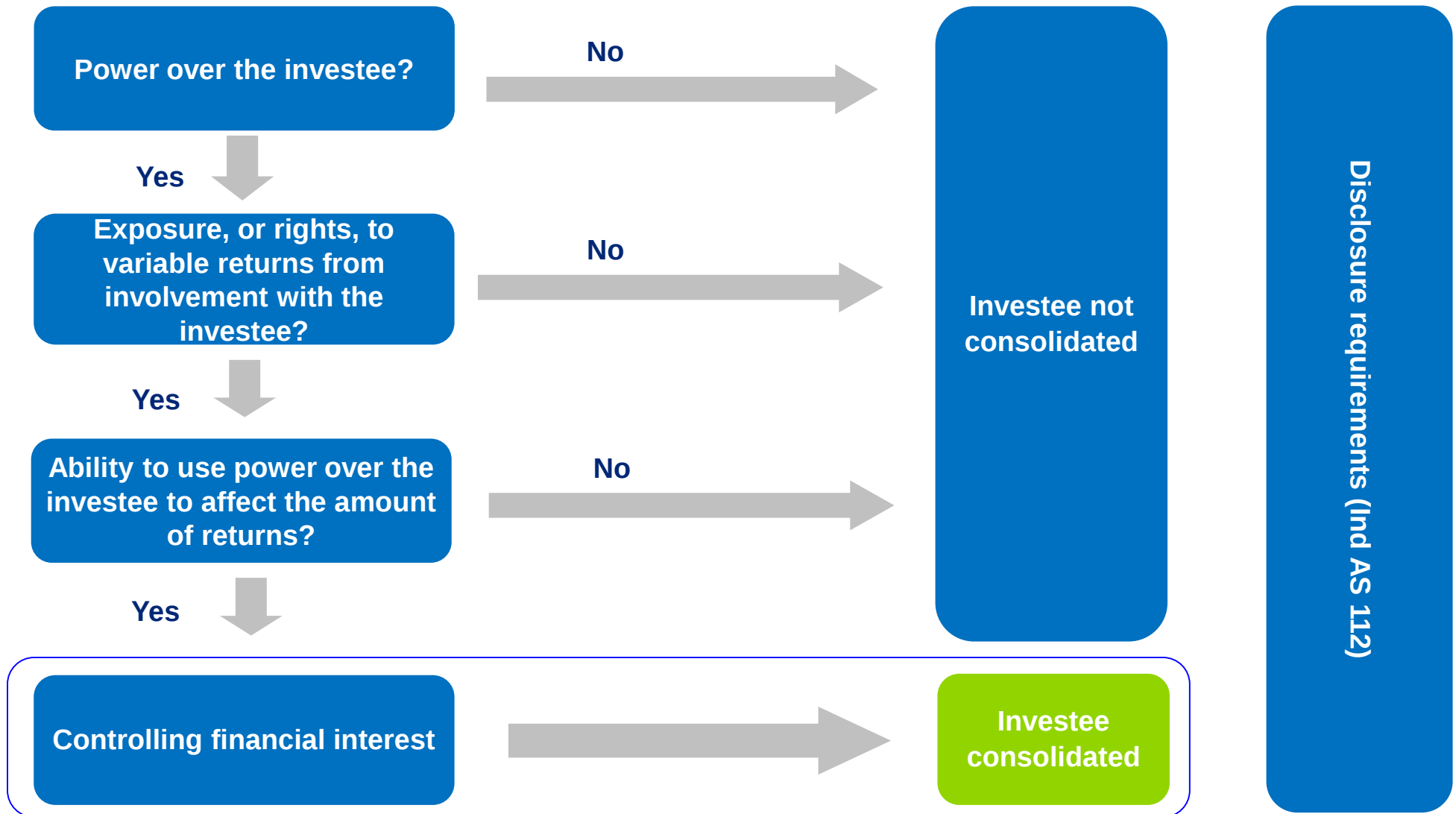
- Consolidation is based on control
- Control may be obtained in various manners, and not solely as a result of the power to direct the financial and operating policies
- Exposure to risks/rewards is one of the factors necessary to the existence of control, but it is never the determining factor



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

The Challenge Ahead

Ind AS 110 consolidation decision process

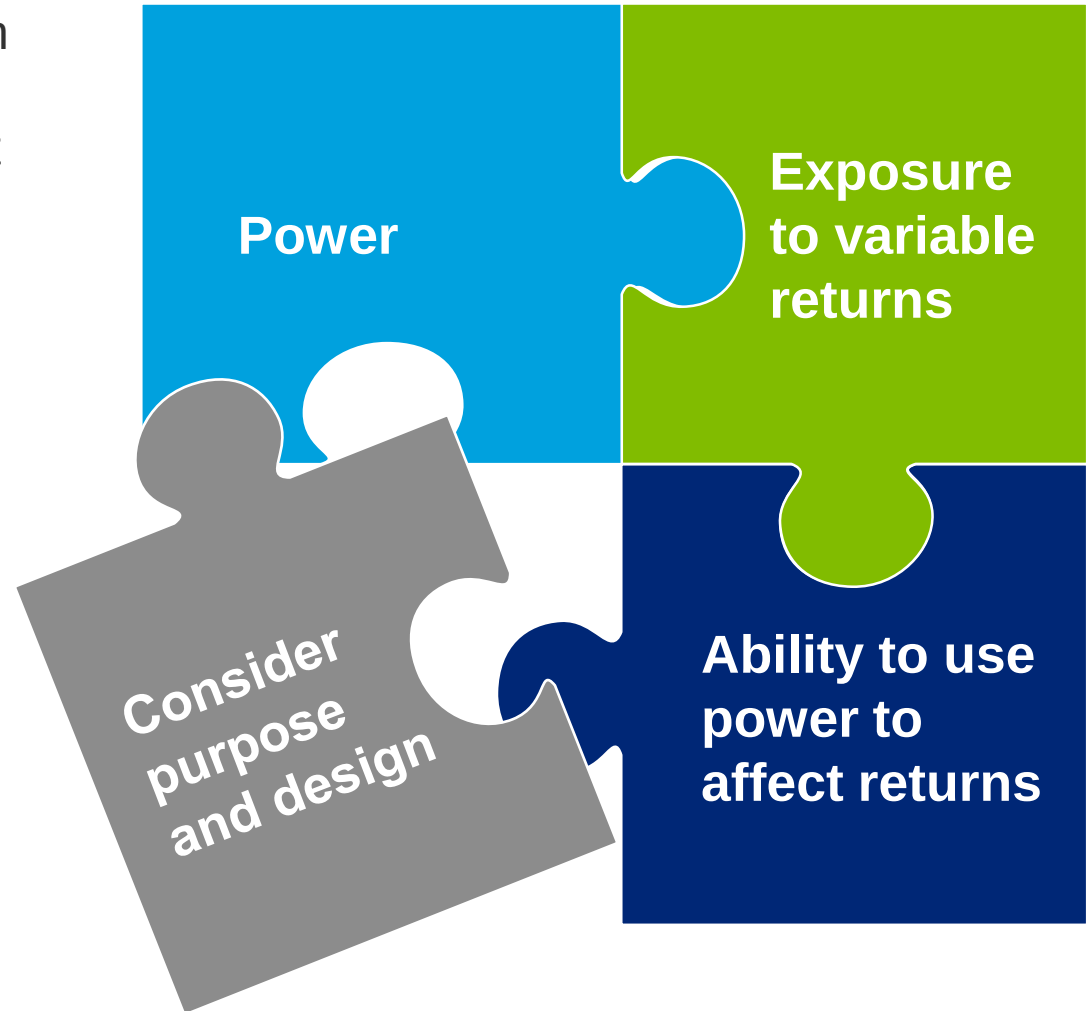


Assessing control

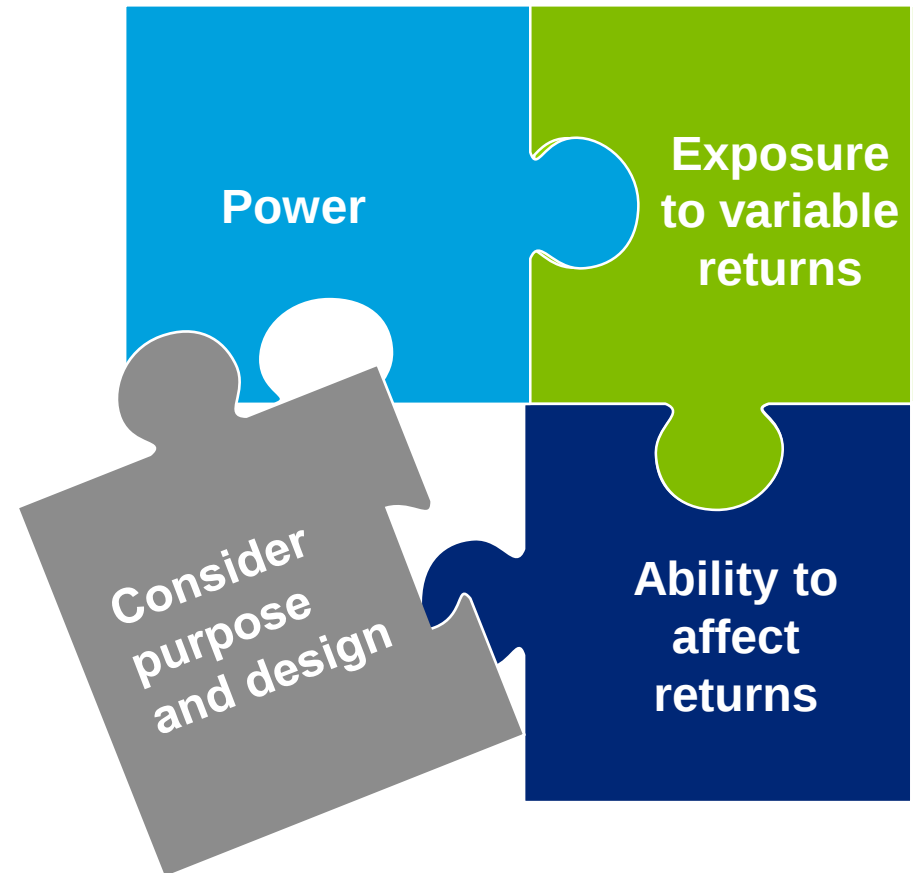
Definition of control

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

Need to apply
professional
judgment!



Analysing control



Analysing control

Power	Rights	• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	
	Relevant activities	
	Exposure to variable returns	
	Ability to affect returns	

Analysing control

Power	Rights	• Majority rights at the board and shareholder level • Consider all options to acquire shares • De facto power—power without a majority of rights (incl. potential voting rights) • Contractual arrangements with other vote holders • Relative size of shareholding • Special relationships with the investee
	Substantive	
	Relevant activities	
	Exposure to variable returns	
	Ability to affect returns	

Analysing control

Power	Rights	• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	• Practical ability to exercise the rights • Current ability to direct relevant activities
	Relevant activities	
	Exposure to variable returns	
	Ability to affect returns	

Analysing control

Power	Rights	• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	• Barriers to exercise voting rights • Potential rights substantive if ability to exercise when decisions on relevant activities are made • Protective rights held by minority group of shareholders do not impede direction of relevant activities
	Relevant activities	
	Exposure to variable returns	
	Ability to affect returns	

Example 1

Fact pattern

- The investee has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled meeting is in eight months.
- Shareholders that individually or collectively hold at least 5% of the voting rights can call a special meeting to change the existing policies over the relevant activities, but such notice requires at least 30 days.
- Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings, e.g., the approval of material sales of assets, acquiring or disposing of significant investments.

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

- a) An investor holds a majority of the voting rights in the investee.
- b) An investor is a party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is 25 days.
- c) An investor holds a substantive option to acquire the majority of shares in the investee that is exercisable in 25 days and is deeply in the money.
- d) Same as b) above except that the forward contract's settlement date is in six months.

Example 1

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

The investor's voting rights are substantive because the investor is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor from having the current ability to direct the relevant activities from the moment the investor acquires the shareholding.

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

The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the investor has rights that are essentially equivalent to the majority shareholder in scenario a) above (i.e., the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled.

Example 1

- c) **An investor holds a substantive option to acquire the majority of shares in the investee that is exercisable in 25 days and is deeply in the money.**

The same conclusion would be reached as in scenario b).

- d) **Same as b) above except that the forward contract's settlement date is in six months.**

In contrast to the scenarios above, the investor does not have the current ability to direct the relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities before the forward contract is settled.

[Based on Examples 3 and 3A-3D of Ind AS 110.B24]

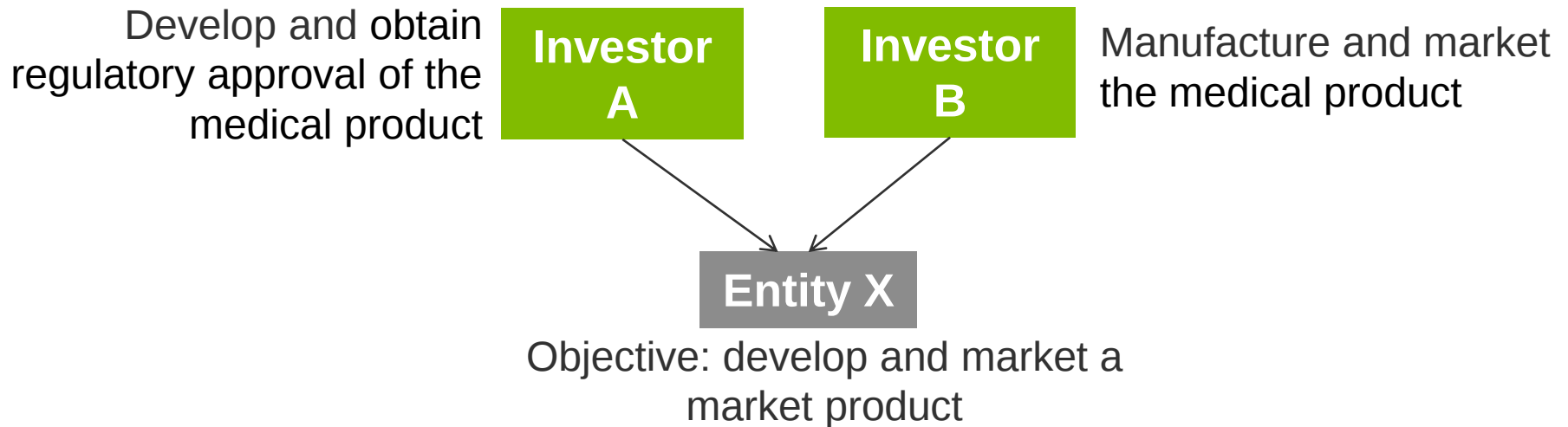
Analysing control

Power		• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	• Practical ability to exercise the rights • Current ability to direct relevant activities • May be passive interest
	Relevant activities	• Activities that significantly affect the investee's returns • How decisions over these activities are made • Purchases/sales, working capital, investments, R&D and financing
	Exposure to variable returns	
	Ability to affect returns	

Analysing control

Power	Rights	• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	• Practical ability to exercise the rights • Current ability to direct relevant activities • May be passive interest
	Relevant activities	• Activities that most significantly affect the returns • Predetermined activities (structured entities)
	Exposure to variable returns	
	Ability to affect returns	

Example 2



More facts:

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

Which investor directs the relevant activities of Entity X?

Example 2

Which investor directs the relevant activities of Entity X?

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

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

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

[Based on Example 1 of Ind AS 110.B13]

Example

Relevant activities

Facts:

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

Issue:

Does the securitisation vehicle have any relevant activities?

Solution:

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

Analysing control

Power	Rights	• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	• Practical ability to exercise the rights • Current ability to direct relevant activities • May be passive interest
	Relevant activities	• Activities that significantly affect the investee's returns • How decisions over these activities are made • Purchases/sales, working capital, investments, R&D and financing
	Exposure to variable returns	• Vary in response to performance • Positive, negative or both
	Ability to affect returns	

Analysing control

Power	Rights	• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	• Practical ability to exercise the rights • Current ability to direct relevant activities • May be passive interest
	Relevant activities	• Activities that significantly affect the investee's returns • How decisions over these activities are made • Purchases/sales, working capital, investments, R&D and financing
	Exposure to variable returns	• Broad definition – returns can be outside of the investee • Can be a fixed return – variability introduced by default or credit risk
	Ability to affect returns	

Examples

Exposure to variable returns

Returns that are fixed in form, but variable in substance

- An investor holds a bond with fixed interest payments. The fixed interest payments are variable returns for the purposes of Ind AS 110 because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability will depend on the credit risk of the bond.
- An investor receives fixed performance fees in return for managing assets of the investee. The fixed performance fees are variable returns because they expose the investor to the performance risk of the investee. The amount of variability will depend on the investee's ability to generate sufficient income to pay the fee.

Example 3

The following instruments embody a right to variable returns. True or false?

Instruments	True	False
Ordinary shares carrying a right to dividends and a proportionate share of residual assets		
Preferred shares carrying a right to dividends (non-cumulative)		
Loan provided to the entity providing the investors with interest income (variable rate)		
Loan provided to the entity providing the investors with interest income (fixed rate)		
Service contracts entitling the service provider with a fixed fee		
Upfront fees received in connection with an ongoing service contract		

Analysing control

Power	Rights	• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	• Practical ability to exercise the rights • Current ability to direct relevant activities • May be passive interest
	Relevant activities	• Activities that significantly affect the investee's returns • How decisions over these activities are made • Purchases/sales, working capital, investments, R&D and financing
	Exposure to variable returns	• Vary in response to performance • Positive, negative or both
	Ability to affect returns	• Affect returns through involvement (power) • Decision maker principal or agent

Agent vs. principal

Power	Rights	• Consider investment in shares by decision maker
	Substantive	• Can the majority shareholder change the decision maker without cause?
	Relevant activities	• Who has the decision over the relevant activities?
	Exposure to variable returns	• How is the decision maker remunerated? • Based on return and/or commensurate to service rendered and market conditions
	Ability to affect return	• The greater the variability in the return for the decision maker, the more likely the decision maker is the principal

Continuous assessment of control

Continuous assessment

- Reassess control if facts and circumstances indicate that changes to one or more elements of control
- A continuous process
- Trigger may or may not due to change in market conditions

Examples

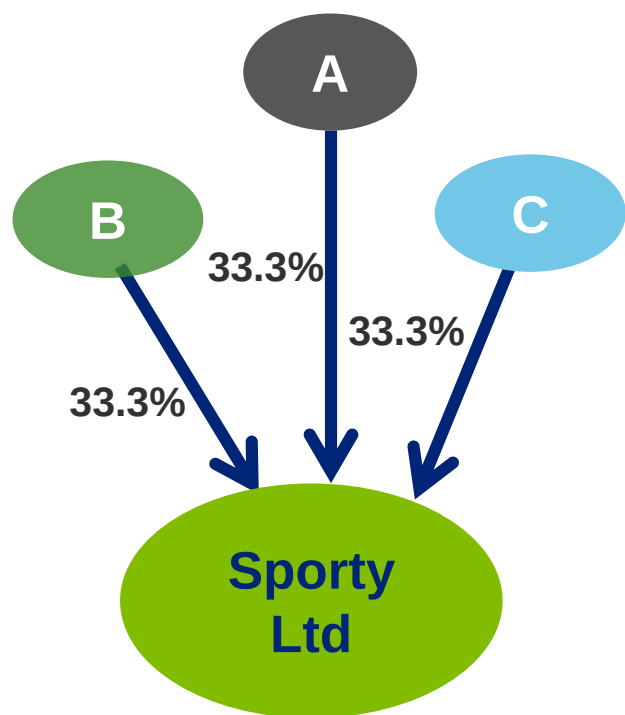
- Where there are potential voting rights that become exercisable or lapse, or where shareholder agreements lapse
- A change in how power over an investee can be exercised, e.g., changes to decision-making rights through contractual arrangement rather than voting rights
- A change affecting the investor's exposure, or rights, to variable returns from its involvement with the investee, e.g., a contract to receive performance-related fees is terminated
- A change in the overall relationship between the investor and other relevant parties that may change the status of the investor as to whether it acts as a principal or an agent

Analysing control recap

Power	Rights	• Depends on nature of activities, legal structure and decision making • Voting rights, potential voting rights • Contractual rights
	Substantive	• Practical ability to exercise the rights • Current ability to direct relevant activities • May be passive interest
	Relevant activities	• Activities that significantly affect the investee's returns • How decisions over these activities are made • Purchases/sales, working capital, investments, R&D and financing
	Exposure to variable returns	• Vary in response to performance • Positive, negative or both
	Ability to affect return	• Affect returns through involvement • Decision maker principal or agent

Putting the theory into practice

Assessing Control: basic principles



Q1

Does shareholder A have control over Sporty?

Key Facts:

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

Ind AS 110.Example 10

Accounting response: Control analysis

1. Power

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

2. Exposure to variable returns

- Exposure via equity holdings in Sporty

3. Ability to use power to affect the returns

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

CONTROL

- A controls Sporty – Three elements of control met

Key implementation issues

Scenarios:

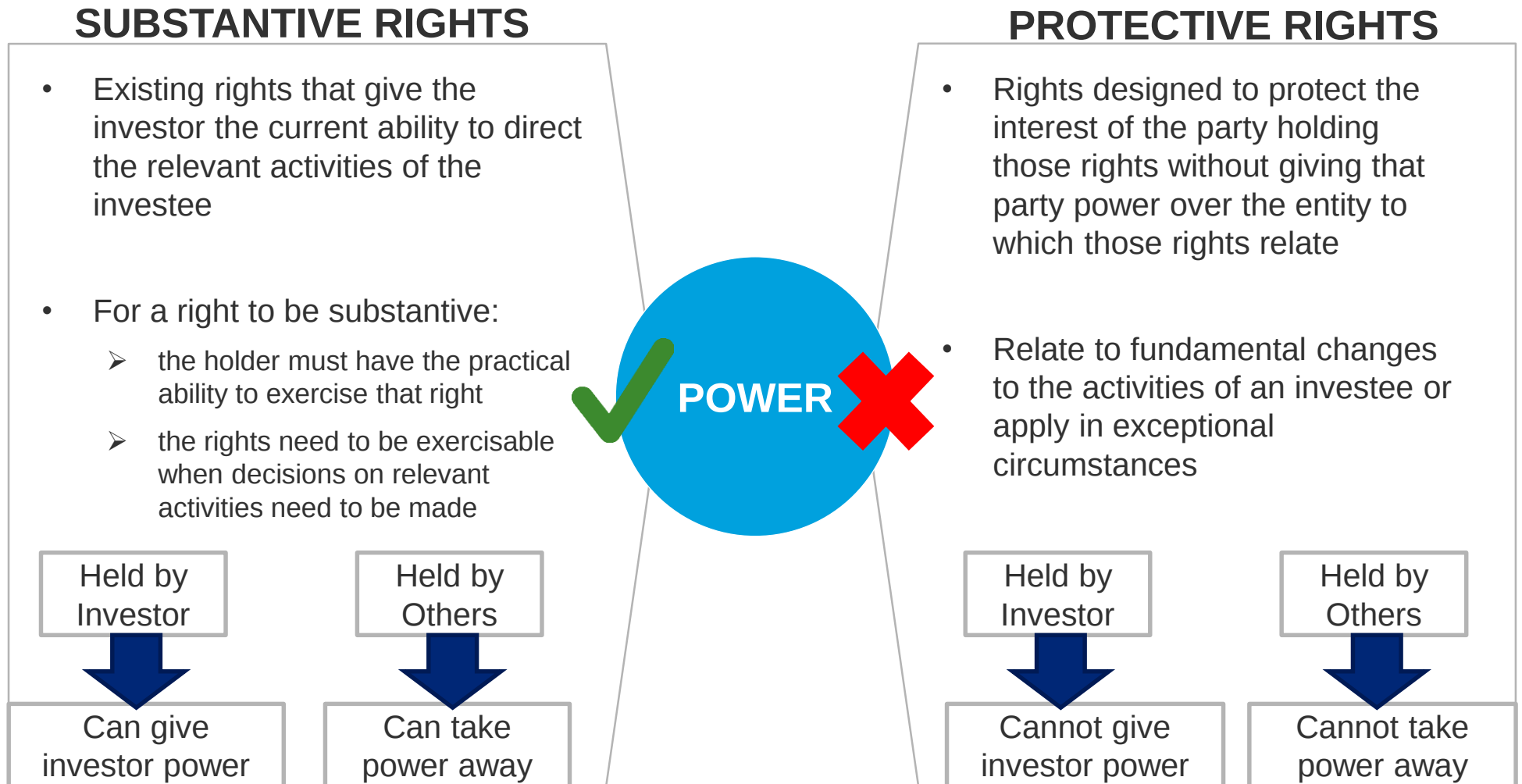
1. **Assessing control: Substantive vs. Protective Rights**
2. **Power with less than majority of voting rights**
3. **Potential voting rights**

1. Assessing control: Substantive vs. Protective Rights

The challenges...



1. Assessing control: Substantive vs. Protective Rights

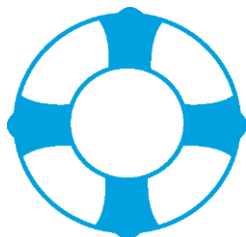


1. Assessing control: Substantive vs. Protective Rights

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



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



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

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

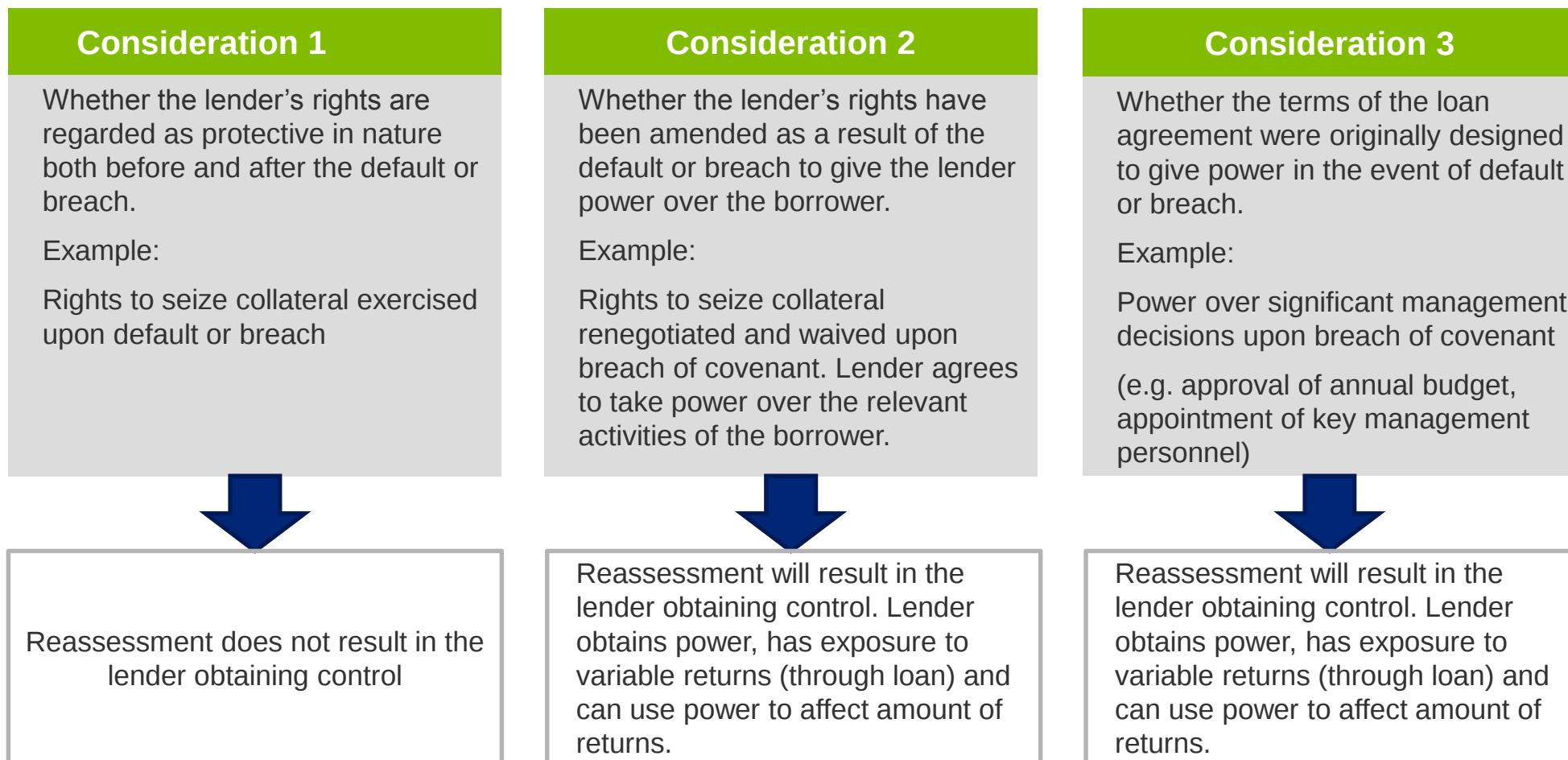
Question:

Will the protective rights held by the bank remain protective in nature when Entity A has defaulted?

1. Assessing control: Substantive vs. Protective Rights

Accounting response

It depends. There is a need to consider what are the rights given to the lender (i.e., bank) in the event of default by the borrower (i.e., Entity A). There are three possible considerations.



2. Power with less than majority voting rights

The challenges...

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

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

Examples of power with less than majority of voting rights (“de facto” control)

Examples of situations where an investor with less than majority of voting rights may have de facto control

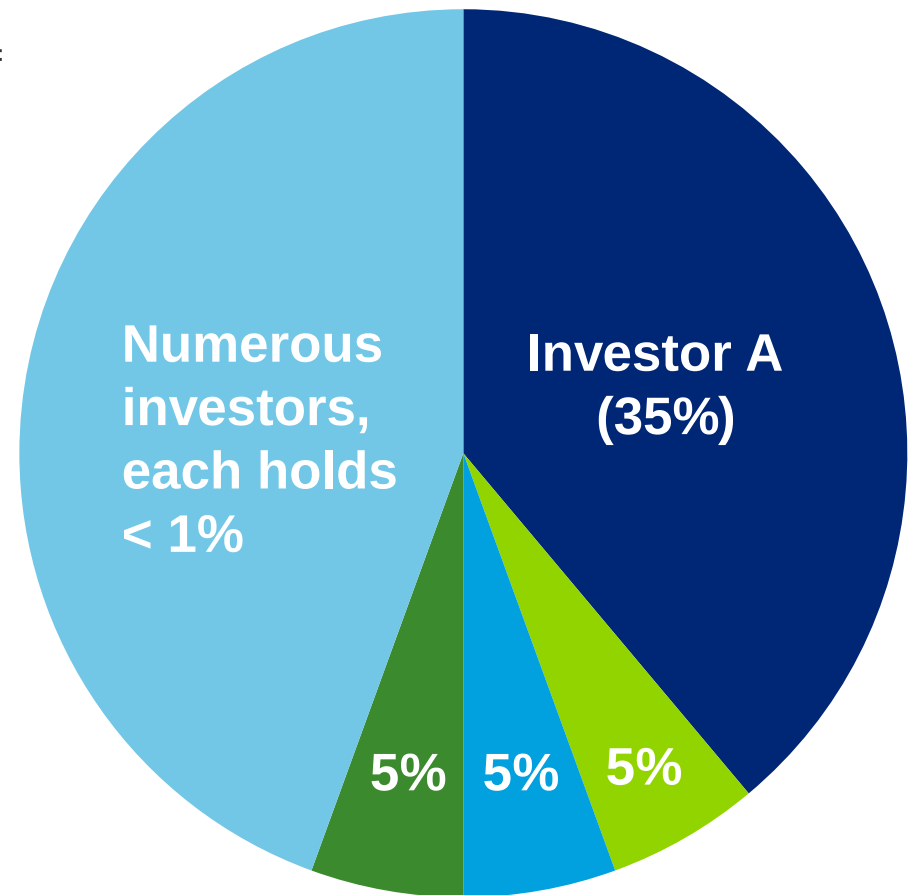
- Contractual arrangements between the investor and other vote holders
- Rights arising from other contractual arrangements, such as operational or financial agreements that may provide significant substantive rights
- Relative size of the investor’s % of vote and dispersion of the voting rights
- Assess past attendance at shareholders’ meeting
- Potential voting rights of the investor and/or other investors

Power with less than majority voting rights

Ind AS 110.B41 states that 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

Key Facts:

- Investor A holds 35% of the voting rights of the investee
- Three other shareholders, each hold 5%
- The remaining shareholdings are held by numerous investors, each holding not more than 1%
- Decisions on relevant activities require casting of majority votes at shareholders meeting
- No agreement exists between shareholders to make collective decisions
- Active participation of other shareholders at recent meetings—75% votes have been cast



Ind AS 110.Example 8

Power with less than majority voting rights

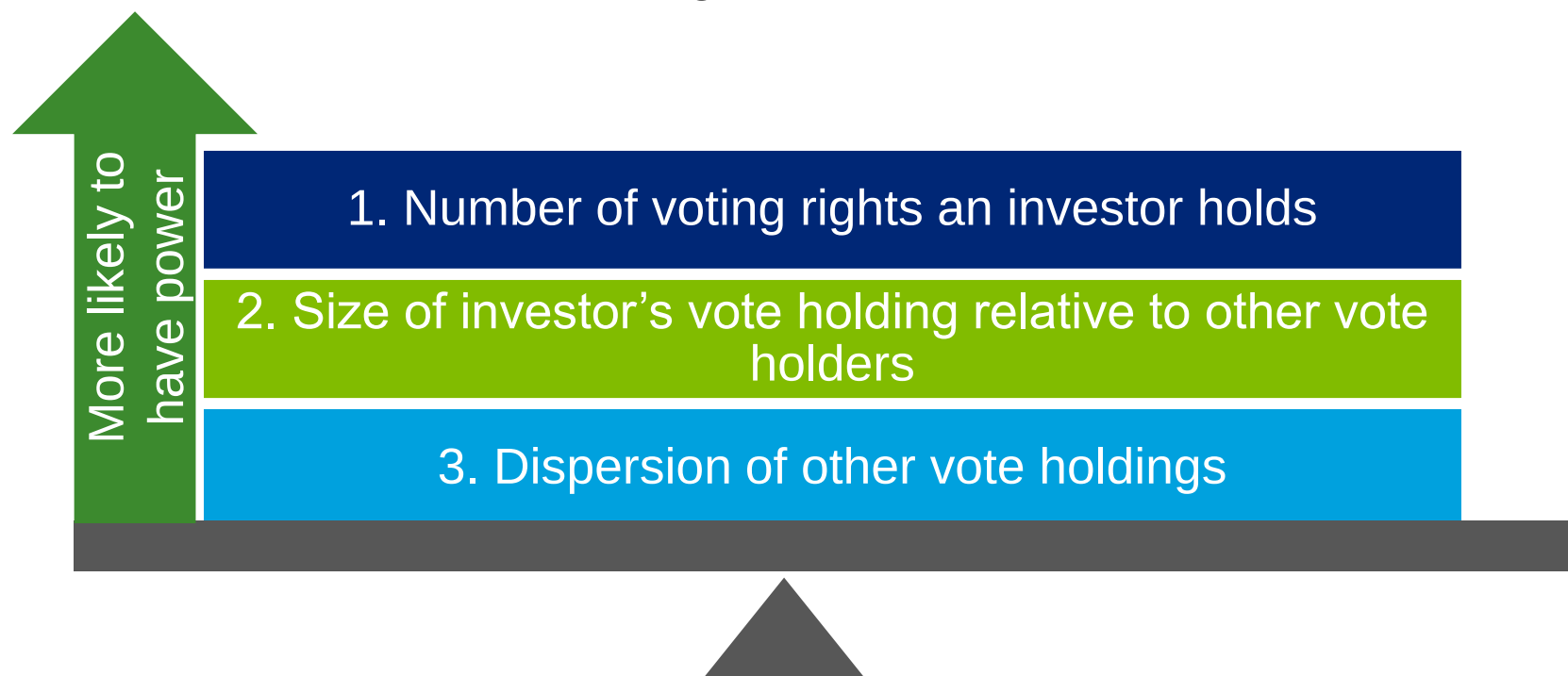
Q1

What are the considerations involved in determining whether investor A has control over the investee?

Consideration points:

Three main considerations:

1. Investors voting rights vs. size and dispersion of holdings of the other vote holders. In making this assessment, need to consider:



In this case, the absolute size of the investor's holdings and the relative size of the other shareholdings alone are **NOT** conclusive in determining whether Investor A has rights sufficient to give it power.

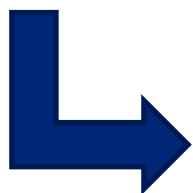
Power with less than majority voting rights

Consideration points (continued):

2. Potential voting rights held by the investor, other vote holders or other parties
3. Rights arising from other contractual arrangements

The consideration of these three factors are **NOT** conclusive as to whether the investor has power. Hence, additional facts and circumstances need to be considered. This includes:

- Voting patterns at previous shareholders' meeting
- Whether there are any arrangements between shareholders to make decisions collectively
- Rights to appoint, remove or set the remuneration of the investee's key management personnel
- Special relationship with the investee



Investor A does not have the practical ability to direct the relevant activities unilaterally

Potential voting rights

The challenges...

1. Considerations of whether potential voting rights are substantive is not limited to assessment of exercise price against the market price - should also consider, the purpose and design of the instrument, as well as the investor's apparent expectations, motives, and reasons for agreeing to the terms surrounding the potential voting rights.
2. Robust analysis is required to be performed in determining whether potential voting rights held are substantive.

Potential voting rights



Key facts:

Alpha holds 45% of the ordinary shares of Omega.

Alpha has an option to acquire an additional 10% of Omega's shares.

The option is exercisable over the next one year and is out of the money.

QUESTION 1:

Alpha does not have control over Omega as the option is not substantive (i.e., out of the money).

True or False?

QUESTION 2:

What are the disclosures required under Ind AS 112?

Potential voting rights

Q1

Alpha does not have control over Omega as the option is not substantive (i.e., out of the money). True or False?



Accounting response:

- It depends. Conclusion cannot be made solely based on the fact that the options are out of the money (i.e., not substantive)
- Determining whether the option held by Omega is substantive is not based solely on the strike or conversion price of the option and the then current market price of its underlying share.
- Other factors to be considered



Judgment is essential!

Potential voting rights

Q2

What are the disclosures required under Ind AS 112?

Accounting response:

- Significant judgment and assumptions made in determining whether Alpha has control over Omega
- Disclosures about the non-controlling interests (e.g., summarised financial information)



Case Study 1

De facto Control

Facts:

- A Co. specialises in the design and manufacturing of carpets. It owns 100% of R Co., which operates in the same industry. A Co. decides to make R Co. a publicly traded entity, retaining 30% of the equity (and related voting rights) of R Co.
- The other 70% of the voting rights are widely distributed among thousands of shareholders, none individually holding more than 1% of the voting rights. At the time of retaining the 30% voting interest, A Co. signed a contract with R Co. that allows A Co. to manage and operate all of the activities of R Co. R Co. has no employees of its own.
- In order to cancel the management and operations contract with A Co., approval by 75% of the votes attached is required.

Issue:

Does A Co. continue to control R Co.?

Case Study 1

De facto Control

Solution:

Yes.

According to Ind AS 110, given the ability of A Co. to direct the relevant activities of R Co through the combination of the contractual arrangement and the 30% voting interest, A Co. would conclude that it controls R Co and thus should consolidate that entity.

In determining whether an investor with less than a majority of the voting rights has rights that are sufficient to give it power, it is necessary, as a first step, to consider the following factors from Ind AS 110.B42:

- a. The size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders.
- b. Potential voting rights held by the investor, other vote holders or other parties.
- c. Rights arising from other contractual arrangements

Case Study 1

De facto Control

Solution (continued):

- In this case, A Co. would consider all of its rights, both voting and contractual, relating to R Co in its control assessment.
- A Co.'s 30% shareholding in R Co prevents other parties from changing the contractual arrangement A Co. uses to direct the relevant activities of R Co (i.e., the contract between A Co. and R Co cannot be changed without A Co.'s approval).
- Accordingly, analysis of the factors given in Ind AS 110.B42 (a) to (c) are sufficient to conclude that A Co. controls R Co.

Case Study 2

De facto Control

Facts:

- C holds 48% of the equity (and related voting rights) of M.
- Remaining equity and voting rights held by numerous other shareholders, none individually holding more than 1%
- None of the shareholders has arrangements to consult any of the others or make collective decisions.
- Decisions about relevant activities of M require the approval of a majority at shareholders' meetings.
- 70% of the voting rights of the investee have been cast at recent shareholders' meetings

Issue:

Does C control M?

Case Study 2

De facto Control

Solution:

- Yes.
- The absolute size of C's holding and the relative size of the other shareholdings are sufficient to give C power over M.
- C has the practical ability to direct the relevant activities of M unilaterally.
- C has exposure to variable returns and the ability to affect those variable returns through its voting rights.

Case Study 3

Potential Voting Rights

Facts:

- L Co. is a manufacturer of consumer electronics such as phones, tablets, and laptops. L Co. is the market leader and has performed well in past years. It has just released its results for the 2013 year. The shares of L Co. are held 60% by Y Co. and 30% by C Co., while the remaining 10% is held by a group of widely dispersed shareholders. L Co. has 7 directors on its board.
- C Co. purchased an option from Y Co. to purchase a 25% interest in L Co. from Y Co. These options can only be exercised at any time from January 1, 2015 onwards, at a price of Rs.10. The shares of L Co. are currently trading at Rs.4.
- L Co. has received funding from AS Bank. In terms of the funding arrangement, AS Bank has the right to veto any decisions to sell a significant portion of the assets of L Co. Should L Co. breach any of its loan covenants, AS Bank has the right to appoint 4 directors to the board and also veto any budget decisions taken.

Case Study 3

Potential Voting Rights

Facts (Contd.):

The market that L Co. operates in has fierce competition and new products and innovations are fast paced. Consumers want the latest technology and the cost of switching from one product to another is minimal. L Co. has identified that in order to remain competitive in the market, its key drivers are its research and development, marketing/sales, and manufacturing activities.

Issue :

Does Y Co. have control over L Co.?

Case Study 3

Potential Voting Rights

Solution:

- **Y Co. controls L Co.** Y Co.'s 60% interest in L Co. gives it the majority voting rights in L Co. and, therefore, the power to direct the relevant activities of L Co.
- The relevant activities of an entity are those activities that most significantly affect the returns of the entity. L Co. has identified that the activities that most significantly affect their profits and, therefore, their returns, are its research and development, marketing/sales, and manufacturing activities. Therefore, these are the relevant activities of L Co.
- C Co. would not control L Co. as it currently only owns a 30% interest in L Co. The option to purchase the additional 25% interest in L Co. can only be exercised in future (2015 onwards) and, therefore, is not currently exercisable and thus would not be a substantive right in 2013.

Case Study 3

Potential Voting Rights

Solution (Contd.):

- The rights of AS Bank to veto any significant sale of assets of L Co. are protective rights and are, therefore, not substantive. They are designed to protect the interest of AS Bank in L Co. and not provide AS Bank with the power to direct the relevant activities.
- The rights of AS Bank to appoint the majority of the board of directors (four of the seven directors) and veto any budget decisions are only exercisable should L Co. breach any of its loans covenants. These rights are, therefore, not considered to be substantive, as Bank does not have the current or practical ability to exercise power over the relevant activities when these decisions are made.

Case Study 4

Potential voting rights

Facts:

- Investor holds 45% of voting rights of an investee.
- Also, has an option to acquire another 20% of voting rights from another investee.
- This option is exercisable for 51 weeks in a year but is not available in last week of the financial year i.e. not available as at balance sheet date.
- The option is exercisable for a nominal amount.
- Decisions about relevant activities are taken at shareholders' meetings, which are generally held during the first or second quarter of the financial year.

Issue :

Does the investor control the investee entity?

Case Study 4

Potential voting rights

Solution:

- It is important to consider the purpose and design of the potential voting rights.
- The potential voting rights are currently exercisable (they are exercisable for the vast majority of the reporting period) and
- This option is exercisable for 51 weeks in a year but is not available in last week of the financial year i.e. not available as at balance sheet date.
- Investor holding the option has an economic incentive to exercise (that is, the nominal fee is not a barrier to exercise and, in general, exercising would be beneficial to this investor)
- Additionally, the potential voting rights are exercisable when relevant decisions need to be made.
- Therefore, the investor holding the option would consolidate the investee entity.

Case Study 5

Structured Entity (Principal vs. Agent)

Facts:

- Entity A creates a Structured Entity X to manage all of its receivables. Entity A will transfer all of its receivables to Structured Entity X. The Structured Entity manager X will manage all of the receivables and the collection thereof, unless the receivables default.
- On default, Entity A will manage the collection process going forward. All amounts collected by Structured Entity X are paid to Entity A without delay.
- The Structured Entity manager X receives a fixed fee for managing the receivables and can only be replaced due to gross negligence.

Issue :

Jot down the Principal vs. Agent Considerations in this example

Case Study 5

Structured Entity (Principal vs. Agent)

Solution:

Entity A controls the Structured Entity.

Statement	Entity A	Structured Entity manager X
Rights	Entity A has an interest in the structured entity through the receivables that it transfers to the structured entity. Entity A's rights are the ability to transfer the receivables into the Structured Entity.	X does not hold any interest in the Structured Entity.
Substantive	Entity A can only change or remove the Structured Entity manager X due to gross negligence.	X can only be removed due to gross negligence.

Case Study 5

Structured Entity (Principal vs. Agent)

Solution (Contd.)

Statement	Entity A	Structured Entity manager X
Relevant activities	Managing the receivables on default affects the return most significantly of the Structured Entity. As Entity A manages receivables on default, it manages the relevant activities of the Structured Entity.	X only manages the receivables that are not in default and, therefore, does not manage the relevant activities of the Structured Entity.
Variable returns	Entity A's returns are variable as any variation of the return through default accrues to Entity A.	X receives a fixed fee for managing the Structured Entity.

Case Study 5

Structured Entity (Principal vs. Agent)

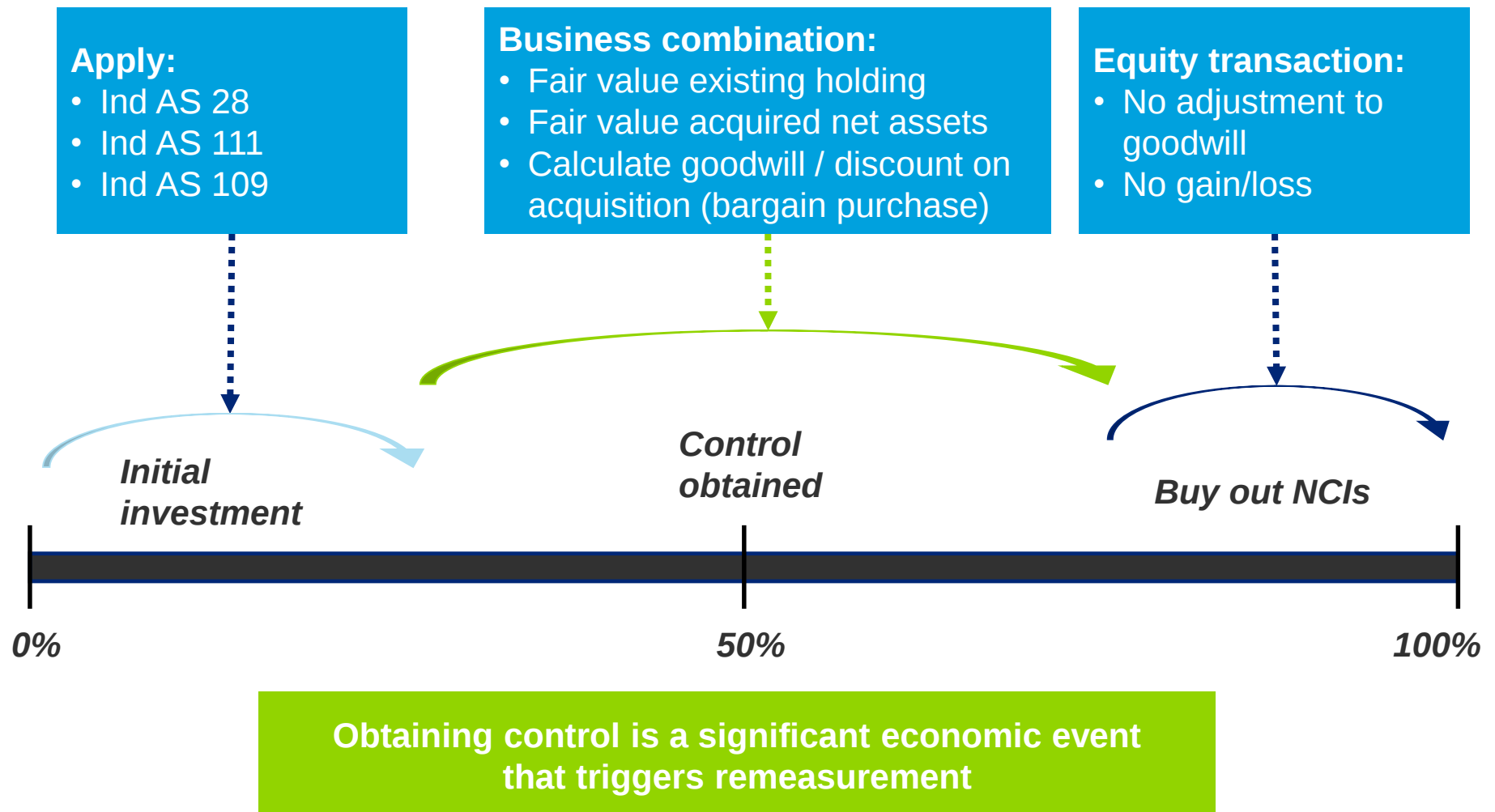
Solution (Contd.)

Statement	Entity A	Structured Entity manager X
Ability to affect returns	As Entity A manages the process on default, it does have the ability to affect its returns.	X cannot influence its return as it receives a fixed fee.
Control	Entity A controls the Structured Entity as it directs the relevant activities of the Structured Entity, has exposure to variable returns and can influence these returns through its power.	X does not control the Structured Entity as it cannot influence the returns of the Structured Entity, nor does it have exposure to variable returns.

Accounting for changes in ownership interests

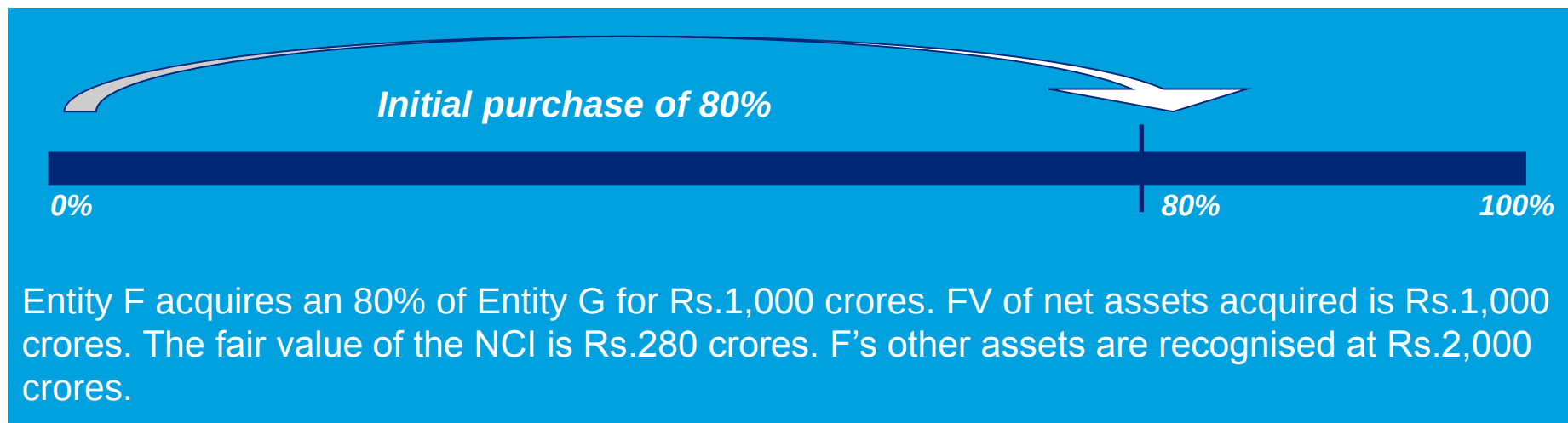
Changes in ownership interests

Increase in ownership interests



Example

Step 1: Acquiring controlling interest



To measure NCI and calculate goodwill:

Basis of determining NCI →	NCI based on fair value (Rs in Crores)	NCI based on net assets (Rs in Crores)
Consideration transferred	1,000	1,000
(+) Non-controlling interest	280	200
(-) Net assets	(1,000)	(1,000)
Goodwill arising in the combination	280	200

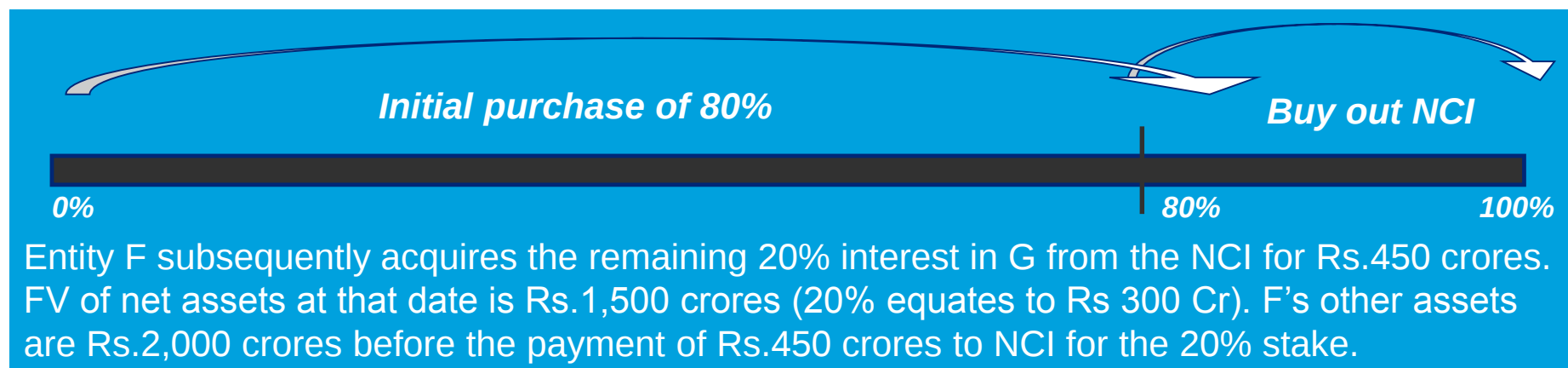
Example – cont'd

Consolidated Balance Sheet:

Basis of determining NCI →	Fair value (Rs in Crores)	Identifiable net assets (Rs in Crores)
	80%	80%
Net identifiable assets acquired	1,000	1,000
Goodwill arising in the combination	280	200
Entity F's other assets (including cash)	2,000	2,000
Consolidated net assets	3,280	3,200
Non-controlling interest	280	200
Reserves	-	-
Other equity	3,000	3,000
Total equity	3,280	3,200

Example – cont'd

Step 2: Post-control changes in ownership interest

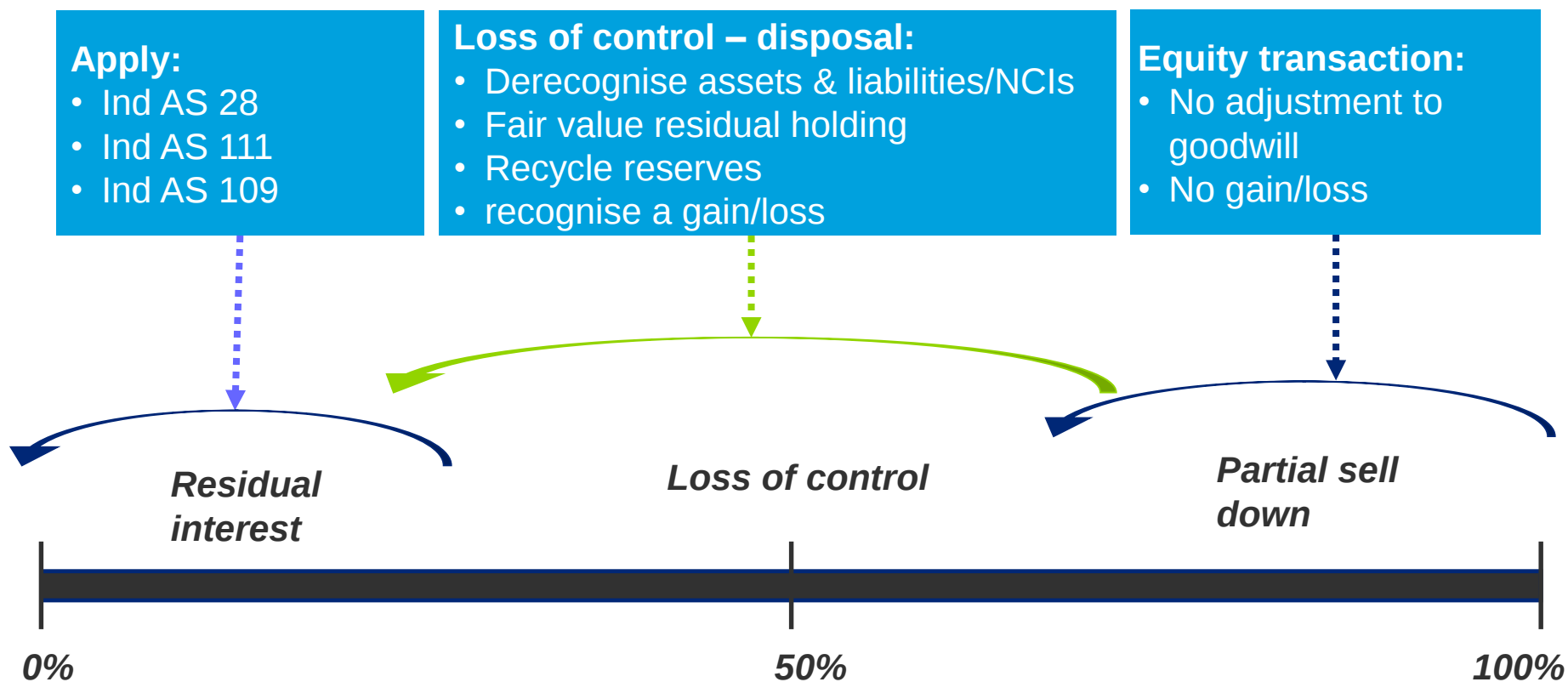


Basis of determining NCI→	Fair value (Rs in Crores)		Identifiable net assets (Rs in Crores)	
	80%	100%	80%	100%
Net identifiable assets acquired	1,000	1,000	1,000	1,000
Goodwill arising in the combination	280	280	200	200
Entity F's other assets (including cash)	2,000	1,550	2,000	1,550
Consolidated net assets	3,280	2,830	3,200	2,750
Non-controlling interest	280	-	200	-
Reserves	-	(170)	-	(250)
Other equity	3,000	3,000	3,000	3,000
Total equity	3,280	2,830	3,200	2,750

Control remains = no adjustment to goodwill

Changes in ownership interests

Decrease in ownership interests



Ind AS 110.B97 contains guidance on when two or more arrangements are considered 'linked transactions'

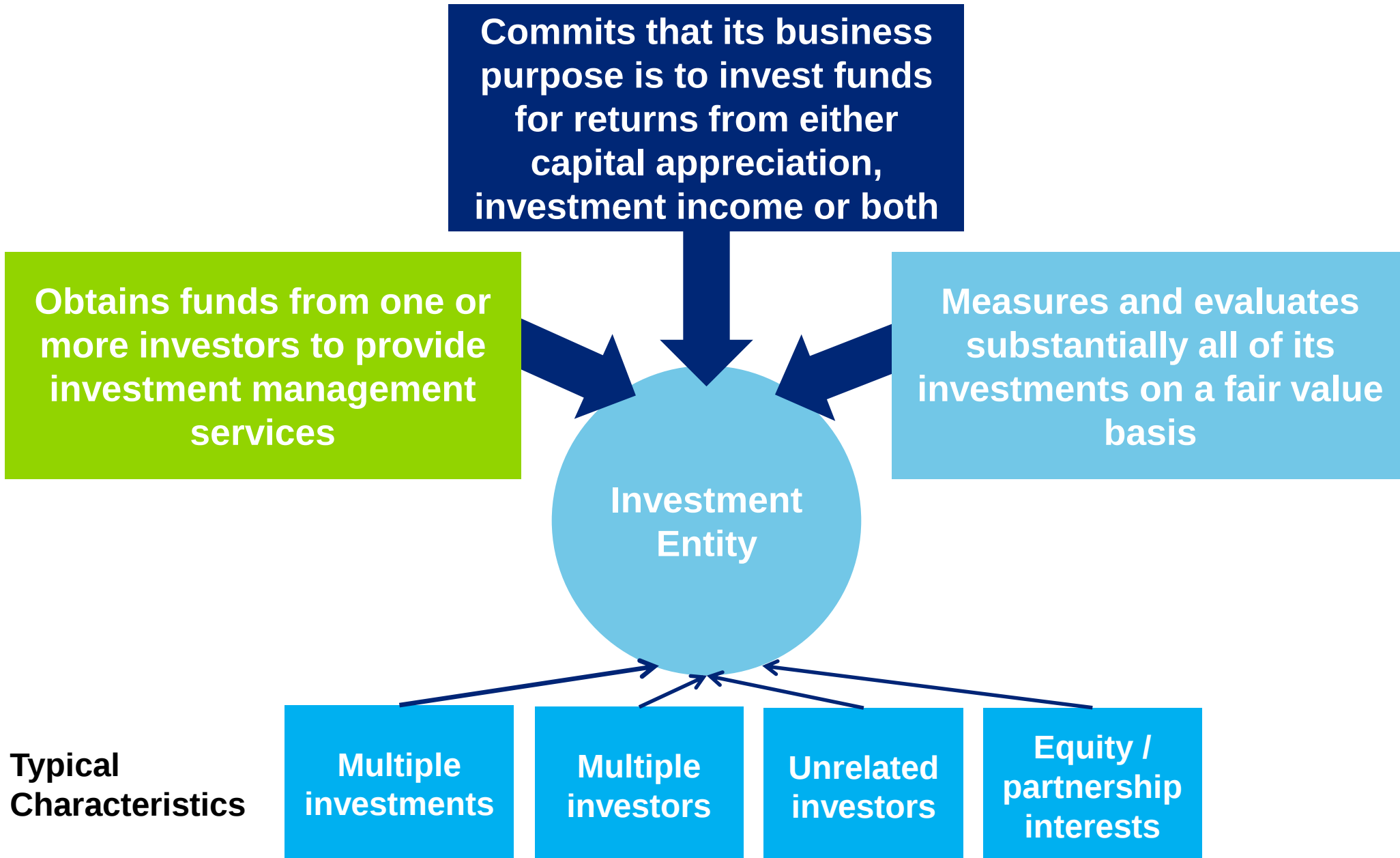
An entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale

Investment Entities

Definition of an investment entity

Investment entities

Definition & typical characteristics



Investment entities

Definition – First element

Obtain funds from one or more investors and provide those investors with investment management services



No detailed guidance provided on this first element

Extent of investment management services may vary

Some entities may provide little or no investment management services but have significant investing activities

For example, mutual funds

Others may provide significant investment management services with little or no investing activities of their own

For example, asset management companies

Investment entities

Definition – Second element

Business purpose is to invest funds for returns from either capital appreciation, investment income or both



As evidenced by:

- Certain documents (e.g. offering memorandum)
- How the entity presents itself to potential investors
- Investment plans

Can provide investment-related services either directly or indirectly to third parties and investors, even if such activities are substantive

Investment entities

Definition – Second element

No intention to hold its investments indefinitely

- Need a **documented** exit strategy for investments that have the potential of being held indefinitely
- All equity and non-financial investments need an exit strategy

Examples of exit strategies

- Initial public offering
- Private placement
- Distributions to investors
- Sale in open market

The investment entity (or another entity in the same group) cannot obtain (or have the objective of obtaining) other benefits from investees that are not available to other parties who are not related to the investee

Examples

- Acquisition or use of assets or technology
- Financial guarantees from the investee
- Option to purchase an interest in the investee
- Other transactions on terms not available to others

Example

Facts:

- HT Fund was formed by T Co. to invest in technology start-up companies for capital appreciation.
- T Co. holds a 70% interest in HT Fund and controls it. Rest 30% held by 10 unrelated investors.
- T Co. holds options to acquire investments held by HT Fund, at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of T Co.

Issue:

Is HT Fund an investment entity?

Solution:

No.

Even though its business purpose is investing for capital appreciation and it provides investment management services to its investors, HT Fund is not an investment entity because it provides benefits in addition to capital appreciation or investment income to T Co. through the options held by the latter.

Investment entities

Definition – Third element

Fair value management



Provides investors with fair value information



Measures substantially all of its investments at fair value (including real estate and other equity/debt investments)



Reports fair value information internally as the primary measurement attribute to evaluate the performance of investments

Investment entities

Typical Characteristics

Multiple investments

But can hold a single investment, for example

- During a start up period
- When in the process of replacing disposed investments
- During liquidation of the entity
- When holding an investment not obtainable by a single investor (club deals)

Multiple investors

But may have a single investor, for example

- When the single investor represents the interest of a wider group (pension funds, government investment fund, family trust) or
- Temporarily as it looks to attract other investors or is being liquidated

Investment entities

Typical Characteristics

Unrelated investors

But all investors may be related to the entity, for example:

- In a parallel fund set up for a group of employees

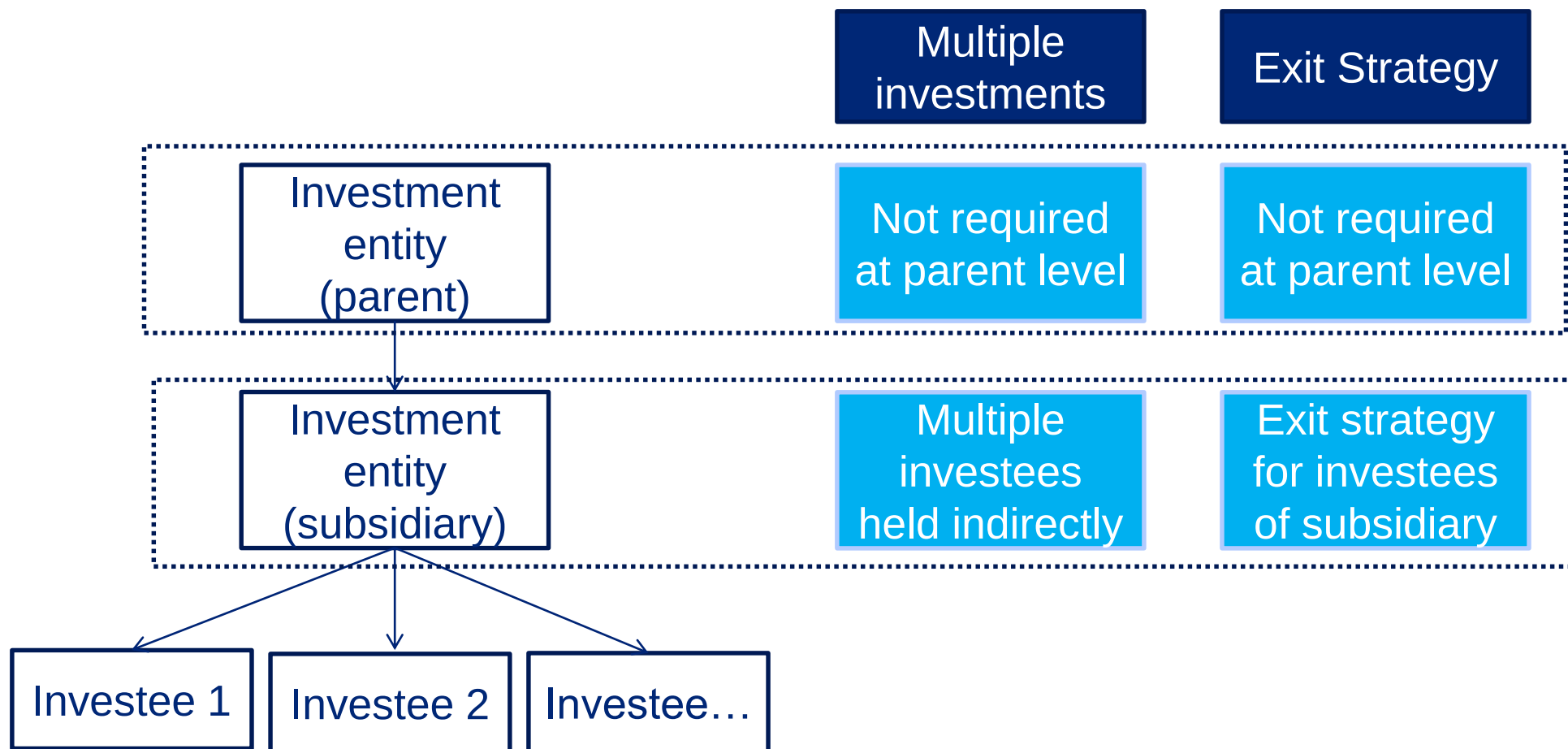
Ownership interests

- Typically a separate legal entity
- Typically ownership interests are in the form of equity or similar interests to which a proportionate shares of the net assets of the entity are attributed
- May still qualify despite having significant ownership interests in the form of debt

Investment entities

Complex fund structures

An investment entity may hold investments through another investment entity established for legal, regulatory, tax or similar business reasons



Measurement requirements

Investment entities

Measurement Requirements

**Investment entities establish
an exception to the consolidation requirements in Ind AS 110**

↳ An investment entity **must** measure investments in subsidiaries at fair value through profit or loss

↳ However, it **must** consolidate those subsidiaries that provide investment-related services

All other investments continue to be accounted for under applicable Ind ASs

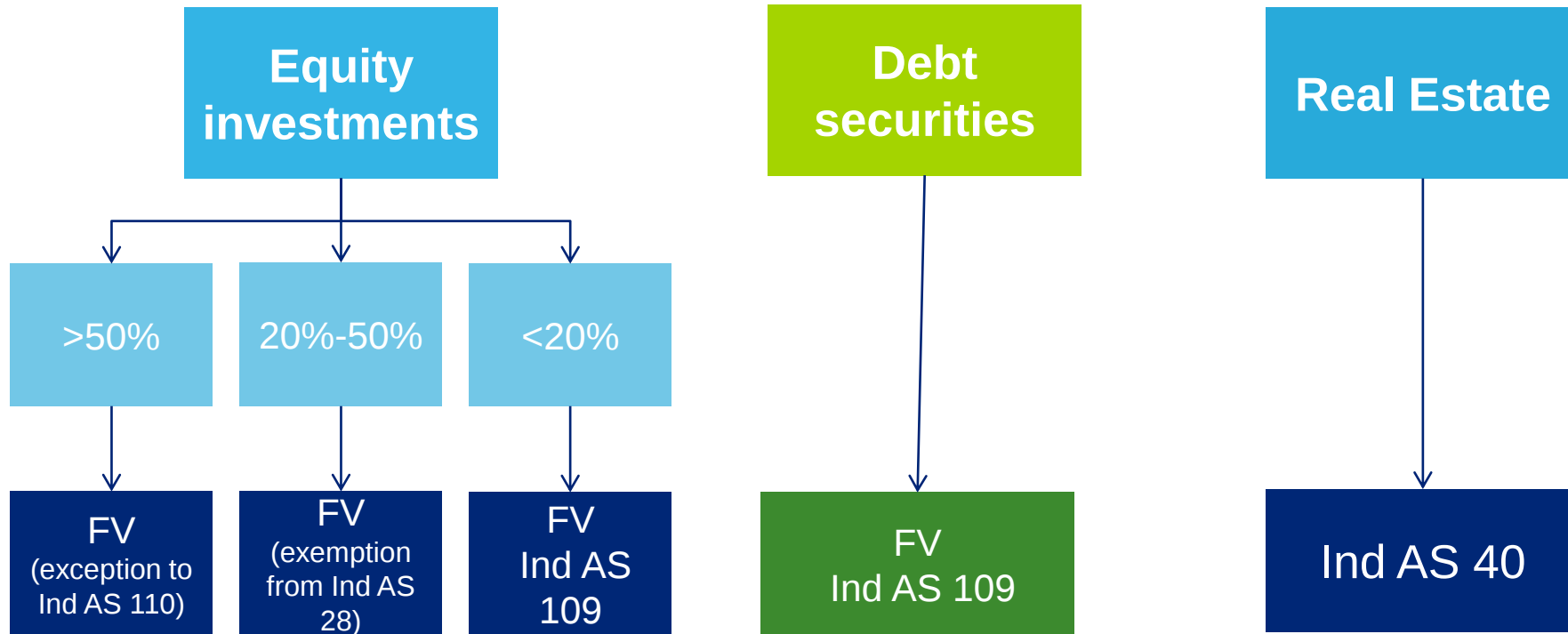
↳ To meet the requirement that it measures and evaluates substantially all of its investments on a fair value basis, an investment entity must

- Elect to account for associates and joint ventures at FV (exemption in Ind AS 28)
- Measure financial assets at FV (Ind AS 109)

Investment entities

Measurement Requirements

An investment entity would account for its investments as follows:



The investment entities establish only an exception to consolidation

Investment entities

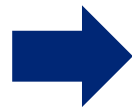
Accounting by a non-investment entity parent

The exception from consolidation does not apply to a non-investment entity parent of an investment entity subsidiary



All entities that are controlled by a non-investment entity parent, including those held indirectly through an investment entity subsidiary, must be consolidated in the parent's financial statements

Associates held through an investment entity subsidiary

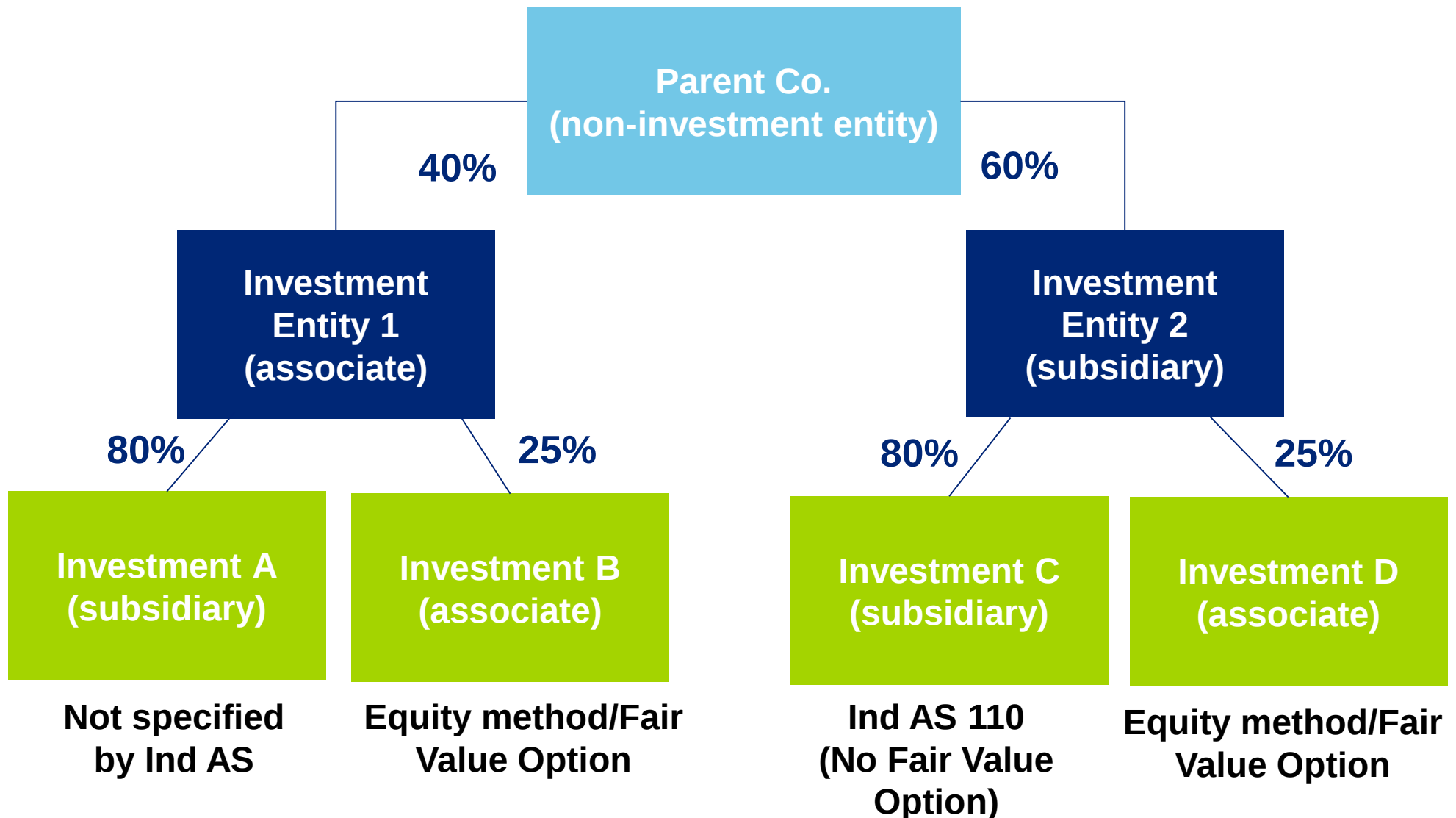


FV option can be retained at the non-investment entity parent level (see Ind AS 28)

Investment entities

Accounting by a non-investment entity parent

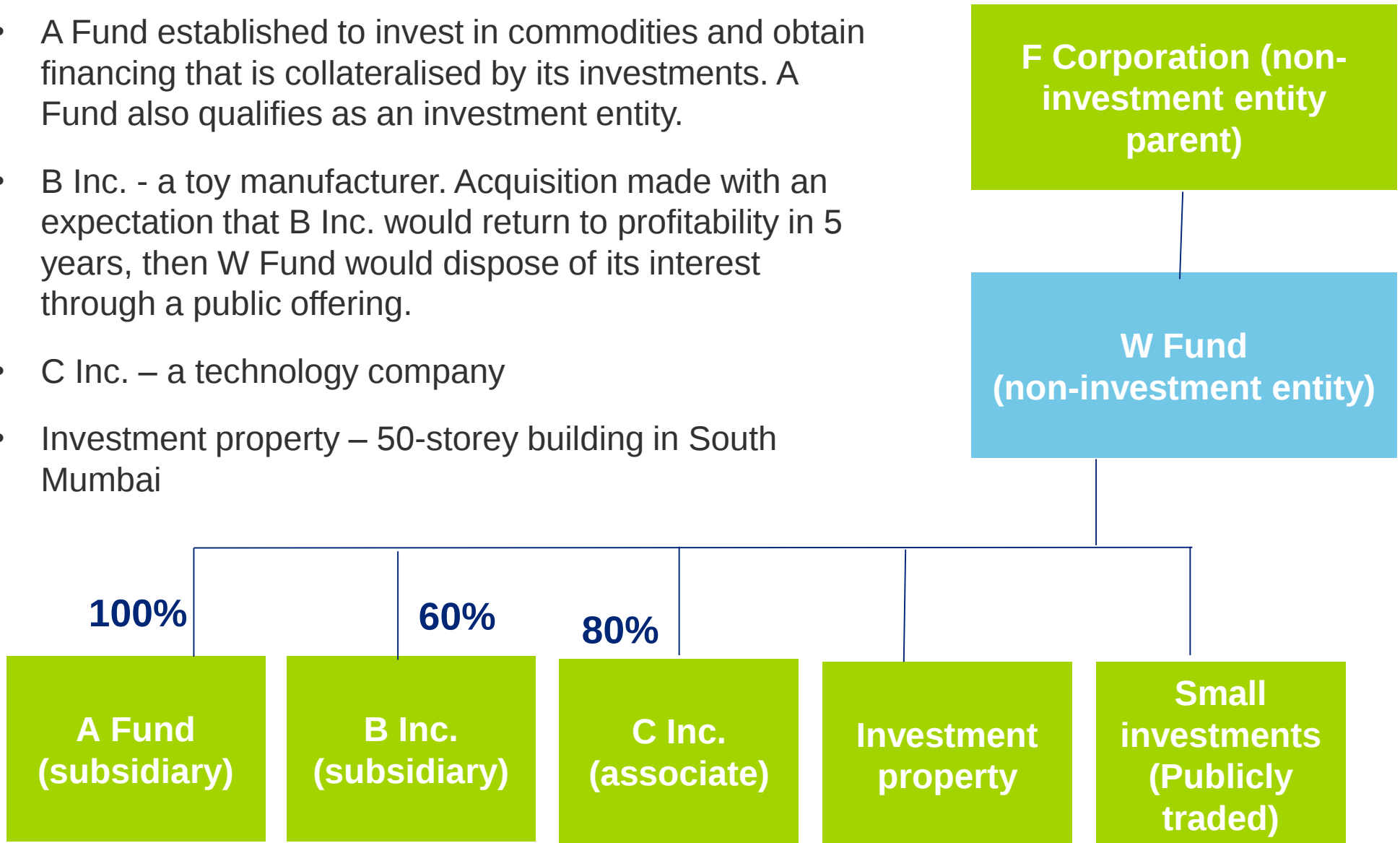
Example: Non-investment entity parent with (1) an investment in an investment entity that is an associate and (2) an investment entity that is a subsidiary.



Case Study

Details of W Fund's investments:

- A Fund established to invest in commodities and obtain financing that is collateralised by its investments. A Fund also qualifies as an investment entity.
- B Inc. - a toy manufacturer. Acquisition made with an expectation that B Inc. would return to profitability in 5 years, then W Fund would dispose of its interest through a public offering.
- C Inc. – a technology company
- Investment property – 50-storey building in South Mumbai



Case Study

Accounting to be done by W Fund:

- A Fund – at fair value in accordance with Ind AS 109
- B Inc. – at fair value in accordance with Ind AS 109
- C Inc. – elect to use the exemption available in Ind AS 28 to not account the investment using equity method and instead account for at fair value in accordance with Ind AS 109
- Investment property – account under Ind AS 40 which allows only cost model and does not allow fair value model
- Small investments (publicly traded) – at fair value in accordance with Ind AS 109

Case Study

Accounting to be done by F Corporation:

- Prohibited from applying the consolidation exception for W Fund's controlling interest investments
- Hence, consolidate A Fund and B Inc. as per Ind AS 110
- B Inc. – at fair value in accordance with Ind AS 109
- C Inc. – can elect to use the exemption available in Ind AS 28.18 to not account the investment using equity method and instead account for at fair value in accordance with Ind AS 109; so either of fair value or equity accounting is allowed
- Investment property – account under Ind AS 40 which allows only cost model and does not allow fair value model; so no difference here compared to accounting by W Fund.
- Small investments (publicly traded) – at fair value in accordance with Ind AS 109