TOPIC 21

INDAS-110

CONSOLIDATED FINANCIAL STATEMENTS

INDEX

Quote:- "The Man Who Has Confidence In Himself,

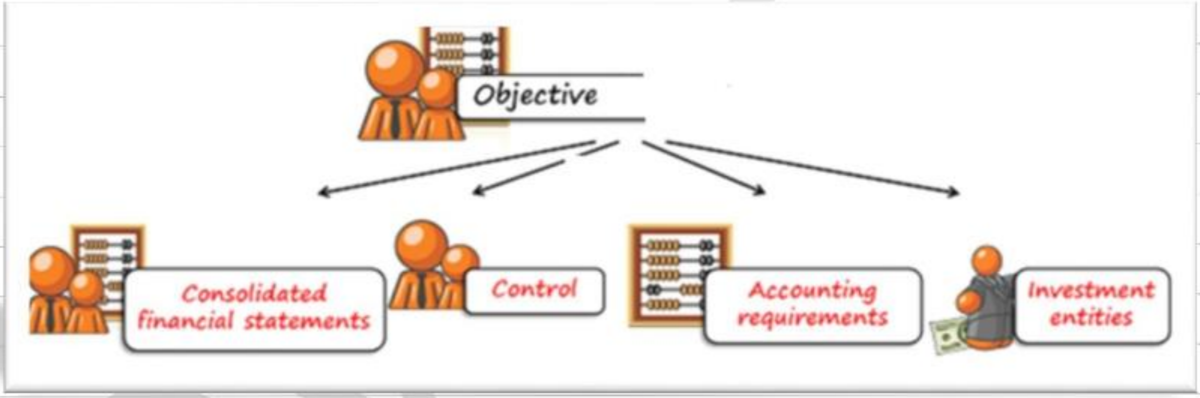
Gains The Confidence Of Others."

WHAT IS THE OBJECTIVE OF INDAS 110?

The objective of INDAS 110 Consolidated Financial Statements is to establish principles for the ***presentation and preparation of consolidated financial statements*** when an entity *controls* another entity.

More specifically, INDAS 110:

- Requires an entity (a parent) that ***controls*** one or more other entities (subsidiaries) ***to present consolidated financial statements;***
- Defines the ***principle of control*** as the basis for consolidation and sets out how to identify whether the investor controls the investee;
- Sets out the ***accounting requirements*** for the preparation of consolidated financial statements, and
- Defines an ***investment entity*** and sets out an ***exception*** to consolidating particular subsidiaries of an investment entity.



CONTROL AS THE BASIS FOR CONSOLIDATION

Simply speaking, the basic rule is:

- If an investor ***controls*** its investee => ***investor must consolidate;***
- If an investor ***does NOT control*** its investee =>; investor ***does NOT consolidate.***

So what is control?

An investor ***controls*** an investee when the investor:

- Is exposed to, or has right to ***variable returns*** from its involvement with the investee;
- Has the ***ability to affect*** those returns
- Through its ***power*** over the investee.

HOW TO ASSESS CONTROL?

Remember 3 basic elements inherent in control: ***power, ability to use this power*** and ***variable returns.***

Power is the existing rights that give the current ability to direct the relevant activities. Let's break it down a bit:

- The rights must be substantive, not only some minor rights;
- The ability must be current, exercisable in the present time;
- The relevant activities must be significant and related to major activities of investee.

In simple situations, control can be demonstrated through voting rights. If an entity controls over 50% of voting rights, entity controls the investee;

However, in complex situations, voting rights may not be the sole indicator. As required by Ind AS, the principle of substance over form shall prevail.

When assessing whether an investor controls an investee, more than one factor need to be considered. INDAS 110 contains guidance in this area.

Apply following steps to assess control

- Check the purpose of the Investee – why it has been formed
- What is the design of the Investee (Firm, Trust, Listed Company, Private Company, Society, SPV etc) and how it is controlled i.e. through voting power, shareholders' agreement, Contractual Arrangment.
- Who takes the decision (who is decision maker) on relevant activities of the Investee - which investor is able to direct the activities that most significantly affect those returns consistently with the treatment of concurrent decision making rights.
- Whether the decision maker is empowered/has the right to take decision – i.e. who has the power? **The rights of the investor could be substantive rights or protective rights.**

Substantive rights

Ownership of more than fifty percent of the voting rights, generally gives an investor the power. But this could be subject to regulatory restrictions, rights held by the other parties. Thus the voting rights may not be substantive.

Example of Substantive Rights:

- 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 direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and
- The investee's key management personnel are related parties of the investor (for example, the chief executive officer of the investee and the chief executive officer of the investor are the same person).
- The majority of the members of the investee's governing body are related parties of the investor.
- other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

Protective rights

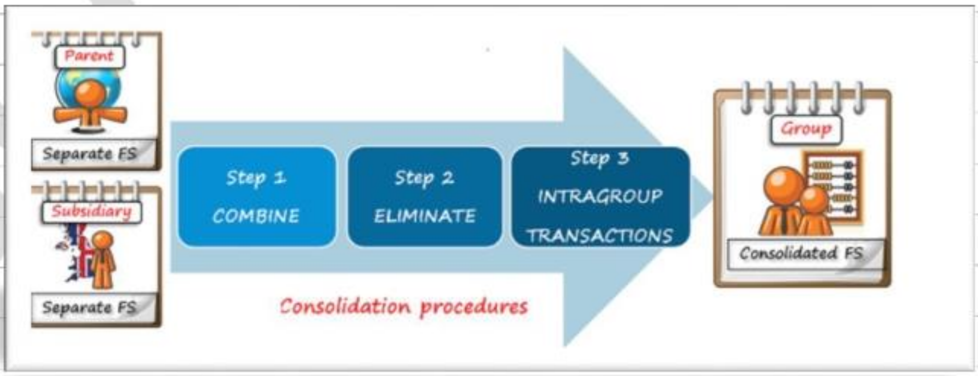
Protective rights are designed to protect the interests of their holders without giving that party power over the investee to which those rights relate. An investor that holds only protective rights **cannot have power or prevent another party from having power over an investee.** Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances.

ACCOUNTING REQUIREMENTS OF INDAS 110

(A) Consolidation procedures

In order to prepare consolidated financial statements, INDAS 110 prescribes the following **consolidation procedures**:

1. **Combine** like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries;
2. **Offset (eliminate):**
   - The carrying amount of the parent's investment in each subsidiary; and
   - The parent's portion of equity of each subsidiary;
3. Eliminate in full **intragroup** assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group.



(B) Other accounting requirements

Except for basic consolidation procedures, INDAS 110 prescribes number of other rules for preparing consolidated financial statements, such as:

- Presentation of ***non-controlling interests:*** in equity, but separately from the equity of owners of the parent;
- ***Uniform accounting policies*** shall be used by both parent and subsidiary;
- The financial statements of the parent and the subsidiary shall have the ***same reporting date***;
- How to deal when the ***parent loses its control*** over subsidiary,

and number of other rules dealing with the specific circumstances.

Note:

If subsidiary uses a different accounting policy then in every subsequent year, when consolidated financial statement are prepared by parent, adjustments to carrying amount of Assets & Liabilities as presented in standalone financial statement of subsidiary would be required so that in consolidated financial statement all Assets & Liabilities of group are valued using same accounting policies **(no exceptions permitted based on impracticability)**

EXCEPTIONS IN INDAS 110

As we discussed above, when a parent controls a subsidiary, then it should consolidate. But not always……. INDAS 110 sets the following **exceptions from consolidation**:

1. A parent does not need to present consolidated financial statements if it meets all of the following conditions:

- It is a **wholly-owned** subsidiary or is a **partially-owned subsidiary** of another entity and its other owners agree;
- 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 organization for the purpose of issuing any class of instruments in a public market, and
- Its **ultimate or any intermediate parent** of the parent produces consolidated financial statements available for public use that comply with INDASs.

2. **Post-employment benefit plans or other long-term employee benefit plans** to which INDAS 19 Employee Benefitsapplies – they don't need to present consolidated financial statements;
3. **Investment entities.**

Student Notes

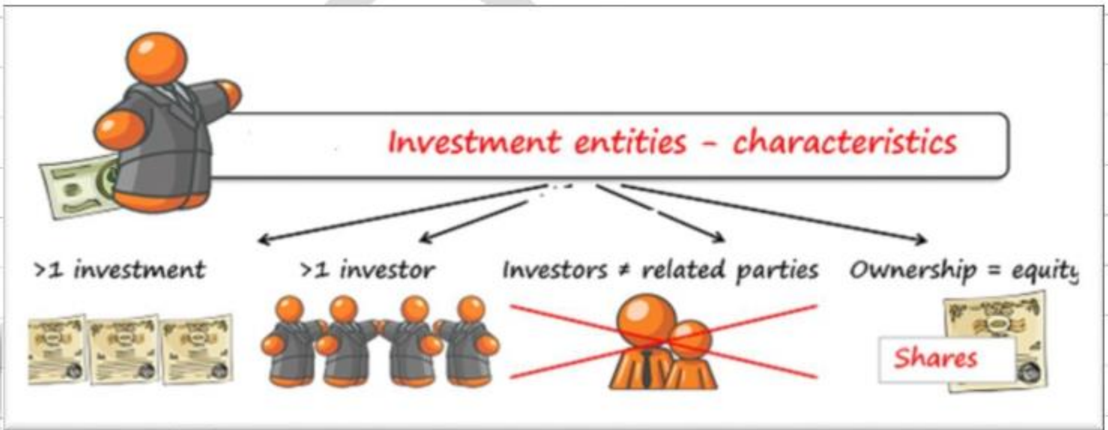
INVESTMENT ENTITIES

Investment entity is an entity that:

1. Obtains funds from one or more investors for the purpose of providing those investor(s) with **investment management services;**
2. Commits to its investor(s) that its **business purpose is to invest funds solely for returns** from capital appreciation, investment income, or both, and
3. Measures and evaluates the performance of substantially all of its investments **on a fair value basis.**

INDAS 110 sets the guidance and rules about determining whether the entity is an investment entity or not. Typical characteristics of investment entities are:

- It has more than one investment;
- It has more than one investor;
- It has investors that are not related parties of the entity;
- It has ownership interests in the form of equity or similar interests.



Most investment entities CANNOT present consolidated financial statements and instead, they need to measure an investment in a subsidiary **at fair value through profit or loss in line with INDAS – 109 Financial Instruments.**

CHANGE IN CLASSIFICATION

I. **Investment Entity** (which was not preparing CFS) —becomes→ **Non-Investment Entity**

- Start Consolidation from the date of change of status when it becomes Non-Investment entity
- Net Assets, NCI and Goodwill/GBP shall be computed on date of reclassification of status

Non-Investment Entity (having subsidiary and preparing CFS) —becomes→ **Investment Company** (Exemped frm CFS)

- On the date of change of Status, we have to de-recognise Net Assets of subsidiary, NCI and Goodwill/GBP if any and Investment in Subsidiary shall be recorded at Fair Value.

Student Notes:-

CASE STUDIES:

Q 243 (Q270 in Old Printed Book)

B Ltd. and C Ltd. had incorporated BC Ltd. to construct & operate a toll bridge. Construction of toll bridge will take 3 years. B Ltd. is responsible for construction. The toll bridge will be operated by C Ltd. Can it be concluded during the construction phase that when B Ltd. has all the authority to take decision that C Ltd. controls BC Ltd.?

Solution

It may appear from the question that B Ltd. has the current ability to direct relevant activities, but this may not be correct. 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.

Q244 (Q271 in Old Printed Book)

In continuation to the facts given in Illustration I, further if it is given that the toll bridge will be constructed under supervision of NHAI by B Ltd. NHAI will reimburse the cost of construction. B Ltd. is entitled to a margin on the construction but from the cash flows of the toll collection before any payment to C Ltd. The toll revenue will be fixed by C Ltd. who is entitled to management fee. From the toll revenue amount the toll expenses will be paid, then margin will be paid to B Ltd. and then management fee will be paid to C Ltd. The balance will be shared equally by B Ltd. and C Ltd.

Solution

In this case C Ltd. has power since C Ltd. is able to direct the activities that most significantly affect the returns. Cost of construction of bridge that is the responsibility of B Ltd. is reimbursed by NHAI therefore it does not significantly affect the returns. Whereas the significant return to the investor is through toll collection activities being the responsibility of C Ltd.

Q245 (Q272 in Old Printed Book)

A Limited has 48% of the voting rights of B Limited. The remaining voting rights 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. Does A Limited have sufficiently dominant voting interest to meet power criterion?

Solution

In the above case, based on the absolute size of A Limited's holding (48%) and the relative size of the other shareholdings, A Limited may conclude that it has a sufficiently dominant voting interest to meet the power criterion.

Q246 (Q273 in Old Printed Book)

A Limited holds 48% of the voting rights of B Limited. X Limited and Y Limited each hold 26% of the voting rights of B Limited. There are no other arrangements that affect decision-making. Who has power to take decisions in the present case?

Solution

In this case, the size of A Limited, voting interest and its size relative to the shareholdings of X Limited and Y Limited are sufficient to conclude that A Limited does not have power.

Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

Q247 (Q274 in Old Printed Book)

An investor holds 35% of the voting rights of an investee. Three other shareholders each hold 5% of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1% of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings — 75% of the voting rights of the investee have been cast at recent relevant shareholders' meetings. Does the investor have ability to direct the relevant activities of the investee unilaterally?

Solution

The active participation of other shareholders at recent shareholders' meetings indicates that the investor would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.

Q248 (Q275 in Old Printed Book)

A fund has been set up by its manager; initially the manager is the only shareholder. As at its first period end, the fund has not been successful in receiving funds from other prospective shareholders; but it is actively soliciting new investors. The fund invests in global equities and equity-related derivatives; and it provides its one shareholder with investment management services (as mandated in its prospectus). Its prospectus states that it expects to buy and sell investments regularly, and it expects holding periods of more than one year to be rare.

The fund generates returns from capital appreciations and investment income in the form of dividends. The fund fair values all investments and these valuations are the basis for subscriptions and redemptions into and out of the fund. Subscriptions and redemptions can occur daily. Is the fund an investment entity?

Solution:

The fund is an investment entity. It meets the definition of an investment entity:

- It has been set up to provide investment management services to its investors. For this period, it has only one manager-shareholder and so it is providing investment management services to itself, but this is not its longer-term manager intention.
- It is carrying on its investment activities with the objective of capital appreciation and investment income.
- It measures its underlying investments on a fair value basis and fair value is the basis for subscriptions and redemptions into and out of the fund.

The fund displays the following characteristics:

- It holds multiple investments.
- It does not have multiple investors; but, this is expected to be temporary and the fund manager is actively soliciting new investors.
- It does not have unrelated investors, because it has only a single investor.
- It issues ownership interests in the form of redeemable units that entitle the holders to a share of net assets.

Although the fund has a single investor, this is expected to be temporary. Failing to meet this typical characteristic does not mean that the fund is not an investment entity. In the context of the definition and the fund's overall business purpose, it is an investment entity. The fund is required to make appropriate disclosures in its financial statements on why it qualifies as an investment entity even when it has only one investor.

Student Notes:-

Student Notes:-