Change in ownership interests in investees

This article aims to:

- Illustrate the accounting for change in control or significant influence on an investee.

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

In the current dynamic economic environment, there is a need for diversification and synergy of resources. Entities may restructure their group, which may involve making investments or divesting their resources.

The accounting for these transactions may sometimes be complicated, especially under the Indian Accounting Standards (Ind AS) regime. An investor and an investee may have various kinds of investment relationships e.g.:

- Investments made without establishing any relationship: Ind AS 109, *Financial Instruments*
- Investor controls the investee: Ind AS 110, *Consolidated Financial Statements* (consolidation)
- Investor has significant influence or joint control: Ind AS 28, *Investment in Associates and Joint Ventures* and Ind AS 111, *Joint arrangements* (equity accounting).

Complexities further arise when there is a change in relationship between the investor and the investee, which necessitates a change in the method of accounting.

In this article, we aim to illustrate the accounting for a change in control or significant influence status of investees of a Non-Banking Financial Company (NBFC) due to change in its equity interests.

Example: Investments held by company N

N Private Limited (company N), an NBFC, has made various investments, including investments in certain companies accounted for as an associate and a subsidiary. On 1 April 2018, company N has the following investments:

Company	Equity holding	Relationship	Accounting method
Company A	30 per cent	Significant influence (Associate)	Equity accounting
Company C	60 per cent	Control (Subsidiary)	Consolidation

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved

Due to certain strategic decisions, company N is required to procure an additional 60 per cent shares in company A for INR180,000 million, and dispose of 20 per cent shares in company C for INR400 million.

The above transactions will result in a change in relationship between the entities, and as a result, in the accounting method. Details of the transaction are given below:

Company	Equity holding	Fair value of existing/retained interest	Net assets	Remarks
Company A	90 per cent	Existing interest in A: INR90,000 million	Fair value of net assets: INR300,000 million	Carrying amount of interest in A on 1 April 2018 is INR87,500 million (includes share of revaluation reserve of INR500 million). Fair value of Non-Controlling Interest (NCI) on 1 April 2018 is INR70,000.
Company C	40 per cent	Retained interest in C: INR800 million	Carrying amount of net assets: INR1,750 million	Other Comprehensive Income (OCI) (net of amounts allocated to NCI) includes foreign currency translation reserve of INR180 million. NCI on 1 April 2018 is INR700 million.

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Accounting issue

Company N needs to evaluate the accounting for a change in relationship with company A from an associate to subsidiary (acquisition of control) and with company C, from a subsidiary to an associate (loss of control) in accordance with Ind AS.

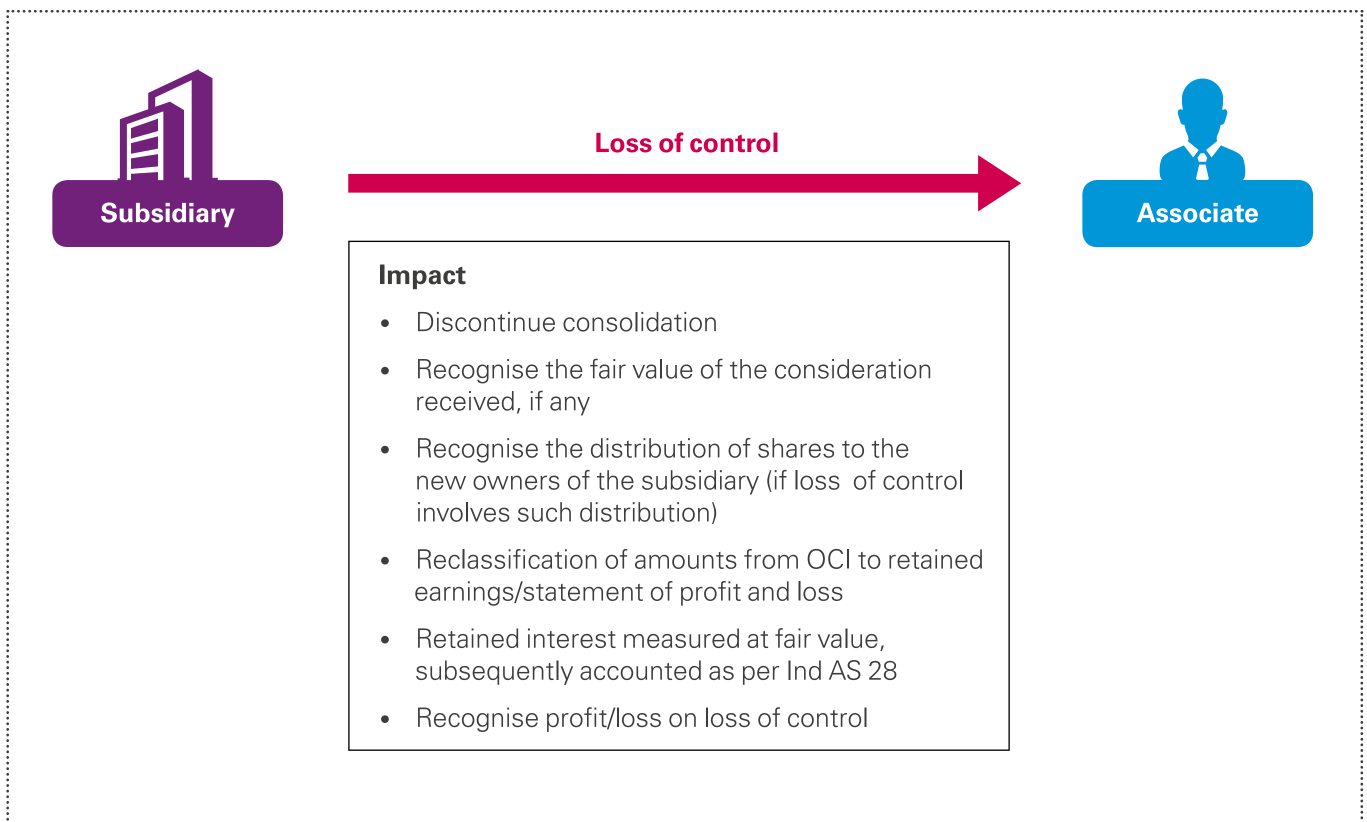
Accounting guidance and analysis

As per Ind AS, any change in equity interests, which causes a change in the method of accounting is considered to be a significant economic event, and accounted for as if the investor's equity interest is sold at fair value and immediately reacquired at that price.

Loss of control

Figure 1 below explains the accounting impact in the consolidated financial statements of company N, when it loses control over company C.

Figure 1: Accounting impact when there is loss of control



(Source: KPMG in India's analysis 2018, read with Insights into IFRS, KPMG IFRG Ltd's publication, 14th edition, September 2017)

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved

Discontinue consolidation

An investor consolidates an investee from the date it obtains control over it, till the date on which it loses control. Accordingly, when company N loses control over company C due to change in its equity interest, it should derecognise the individual assets (including goodwill) and liabilities of C, and the NCI pertaining to subsidiary, including any components of OCI attributable to them.

Recognise profit/loss on loss of control

The amount recognised in the statement of profit and loss on loss of control is computed as below:

Particulars	Amount (INR in million)
Add:	
Fair value of consideration received	400
Fair value of any retained interest	800
Carrying amount of the NCI, including its share of OCI	700
Less:	
Carrying amount of net assets of C	(1,750)
Total profit/loss on loss of control	**150**

(Source: KPMG in India's analysis 2018, read with Insights into IFRS, KPMG IFRG Ltd's publication, 14th edition, September 2017)

Reclassification of amounts from OCI to retained earnings/profit or loss

As per Ind AS 110, amounts recognised in OCI (net of amounts allocated to NCI), pertaining to the subsidiary should be reclassified to the statement of profit and loss or transferred directly to retained earnings (as required by Ind AS), in a similar manner as would be the case on disposal of the subsidiary. Accordingly, the amounts pertaining to the foreign currency translation reserve (INR180 million) should be transferred from OCI to the statement of profit and loss.

It is to be noted that on disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences related to that foreign operation that have been attributed to the NCI forms part of the NCI that is derecognised and is included in the calculation of the gain or loss on disposal, but it is not reclassified to profit or loss.

Retained interest measured at fair value

The 40 per cent interest held in company C should be measured at fair value (i.e. INR800 million) on the date of divestment of the entity's interest. This amount is deemed to be the cost of investee when applying the equity method in accordance with Ind AS 28.

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Accounting entry

N should record the following accounting entry to reflect its loss of control:

Date	Accounting entry	Dr/Cr	Amount (INR in million)
1 April 2018	Cash	Dr	400
	Non-controlling interest[1]	Dr	700
	Foreign currency translation reserve	Dr	180
	Investment in C	Dr	800
	Net assets of S	Cr	1,750
	Profit or loss	Cr	330

Post this, investment in C will be accounted for in accordance with Ind AS 28.

Acquisition of control

When an entity obtains control over an existing associate that meets the definition of a business, in accordance with Ind AS 103, *Business Combinations,* the accounting for such a transaction would be similar to the accounting for a business combination achieved in stages (as prescribed in Ind AS 103).

Figure 2 below explains the accounting impact in the consolidated financial statements of company N, when it acquires control over company A.

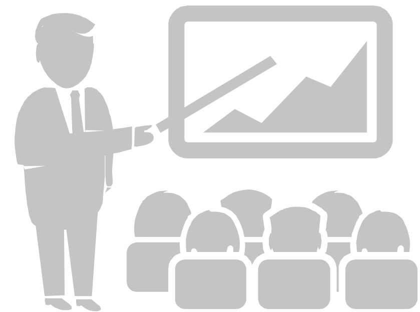
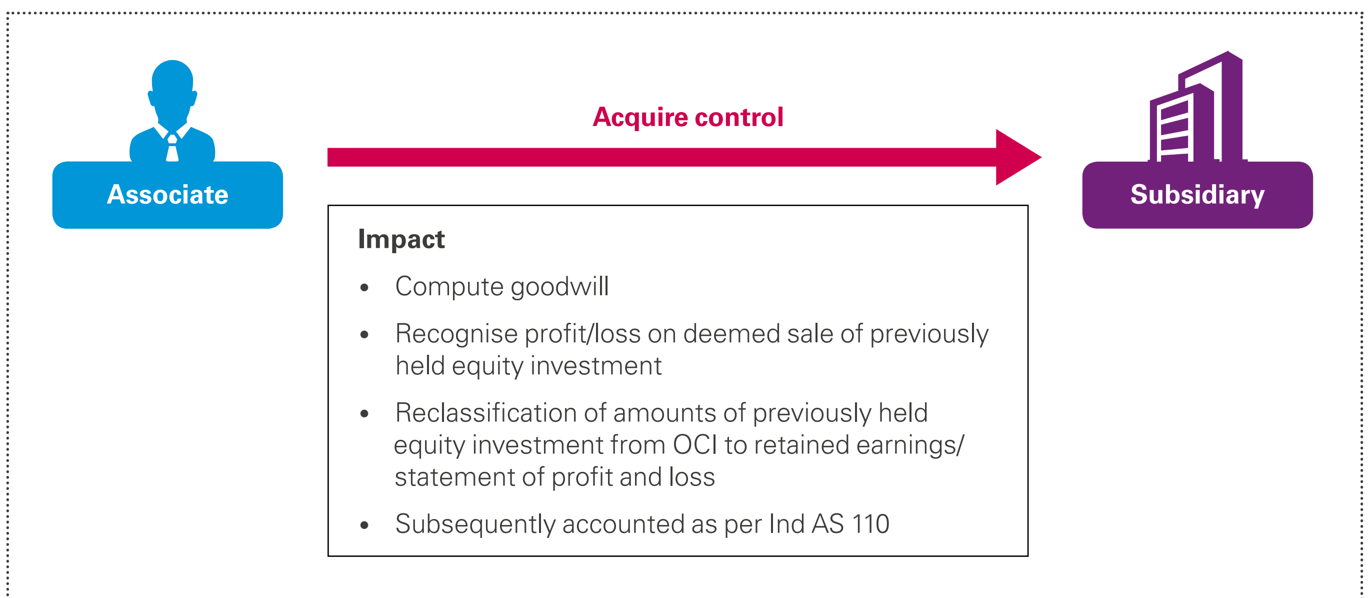


Figure 2: Accounting impact on acquiring control over existing associate



(Source: KPMG in India's analysis 2018, read with Insights into IFRS, KPMG IFRG Ltd's publication, 14th edition, September 2017)"

1. This includes NCI's share of foreign currency translation reserve pertaining to company C

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved

Computation of goodwill

Goodwill represents the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. It is generally computed as the difference between the sum of consideration transferred (measured at fair value) and the NCI[2] in the acquiree, and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed.

In a step acquisition, the fair value of any non-controlling equity interest in the acquiree company, that is held immediately before obtaining control is also used in the determination of goodwill, i.e. it is remeasured to fair value at the date of acquisition[3] with any resulting gain or loss recognised in profit or loss. Accordingly, the goodwill is computed as below:

Particulars	Amount (INR in million)
Add:	
Consideration transferred (generally measured at fair value)	180,000
Amount of NCI in the investee company[4]	70,000
Acquisition date fair value of N's previously held interest in A	90,000
Less:	
Net of acquisition date amounts of the identifiable assets acquired and liabilities assumed, measured at fair value	(300,000)
Goodwill	**40,000**

(Source: KPMG in India's analysis 2018, read with Insights into IFRS, KPMG IFRG Ltd's publication, 14th edition, September 2017)

Profit/loss on deemed sale of investment

The accounting treatment in a step acquisition effectively considers that the investment in the acquiree that was held before obtaining control is sold, and subsequently repurchased at the date of acquisition (at its fair value). Accordingly, a gain or loss on the sale of the investment is computed as below[5]:

Particulars	Amount (INR in million)
Add:	
Fair value of 30 per cent interest in A on 1 April 2018	90,000
Carrying amount of 30 per cent interest in A on 1 April 2018	(87,500)
Gain on previously held interest in A, recognised in profit or loss	**2,500**

Reclassification of amounts from OCI to retained earnings/profit or loss

On obtaining control, amounts recognised in OCI, related to the previously held equity interest are recognised on the same basis as would be required if the acquirer had disposed of the previously held equity interest directly. Accordingly, INR500 million in OCI related to N's share of the revaluation reserve of A would be reversed and credited to retained earnings as it is not permitted to be transferred to the statement of profit and loss as per Ind AS 16, *Property, Plant and Equipment.*

Fair value movements on equity investments that are reported in OCI (as elected in accordance with Ind AS 109 would not be reclassified to the statement of profit and loss.

2. Ordinary NCI may be measured either at fair value or at their proportionate share in the fair value of the identifiable assets and liabilities of the acquire.
3. The date of acquisition for a business combination achieved in stages is the date on which the acquirer obtains control of the acquiree.
4. In the current scenario, N elects to measure NCI at fair value, accordingly, goodwill includes a portion attributable to NCI.
5. This gain or loss is disclosed on the same basis as if the investment had been disposed of to a third party.

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Equity interest measured at fair value

On the date of acquisition, N derecognises its interest in associate A and recognises the net assets acquired in subsidiary A, along with the NCI pertaining thereto. N has an option to initially recognise the NCI either at fair value or at a proportionate interest in identifiable net assets of the acquiree. Thereafter, N would be required to consolidate the financial statements of A with effect from 1 April 2018, in accordance with Ind AS 110.

Accounting entry

Date	Accounting entry	Dr/Cr	Amount (INR in million)
1 April 2018	Identifiable net assets of A	Dr	300,000
	Goodwill	Dr	40,000
	Revaluation reserve	Dr	500
	Cash	Cr	180,000
	NCI (equity)	Cr	70,000
	Investment in associate A	Cr	87,500
	Retained earnings	Cr	500
	Profit or loss (gain on previously held interest)	Cr	2,500

Consider this

- After a parent has obtained control of a subsidiary, it may change its ownership interest in that subsidiary without losing control. This can happen, for example, when a parent buys shares from, or sells shares to the NCI, or through the subsidiary issuing new shares or reacquiring its shares. Transactions that result in changes in ownership interests while retaining control are accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes is recognised in profit or loss, instead it is recognised in equity. Also, no change in the carrying amounts of assets (including goodwill) or liabilities is recognised as a result of such transactions. (NCI being a component of equity).
- If an entity acquires an interest in a non-wholly owned subsidiary, that is not a business, then the requirements of Ind AS 110 would continue to apply, because the scope of the standard is not limited to subsidiaries that are businesses.
- If an entity acquires additional interests while continuing to apply equity accounting, then it does not remeasure the existing interest if an acquisition results in a change in status from an associate to a joint venture, or vice versa. Reserves, such as cumulative foreign currency translation reserve, should not be reclassified to profit or loss or transferred to retained earnings, because doing so would be inconsistent with the continuation of equity accounting and the existing carrying amount.
- In a business combination achieved by contract alone, the acquirer receives no additional equity interests in the acquiree. Therefore, if the acquirer held no equity interest in the acquiree before the business combination, then 100 per cent of the acquiree's equity would be attributed to NCI. If in such circumstances, the acquirer elects to measure NCI at fair value at the date of acquisition, then this would not include any control premium because it is an NCI.

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved