

Query No. 17

Subject: *Consolidation of financial statements of subsidiaries with parent company when operational control does not solely vest with parent company.*¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a Central Public Sector Undertaking (CPSU) under the Ministry of Textiles. During the course of deliberation and discussion while recommending annual accounts to the Board for the financial year 2018-19 by Audit Committee (AC), the Chairman, AC made an inquiry regarding investment in subsidiary, joint venture (JV) and associates vis-à-vis the Company’s JV companies (JVCs) in view of the fact that in spite of the Company having 51% stake in these JVCs, their operational control vests with JV partners. The Chairman, AC further stated that since the Company is not controlling the affairs of the JV companies, rather they are looked after by a Chief Executive Officer (CEO) nominated by JV partners, need of consolidation should be decided by experts as per the Companies Act, Indian Accounting Standard (Ind AS) and other laws/rules in this regard.

2. In pursuance to provisions of section 129 read with section 133 of the Companies Act, 2013 and applicable Accounting Standards, Consolidated Financial Statements (CFS) of the Company and its 5 subsidiaries (JVs) and 1 associate company for the financial year 2014-15 were prepared for the first time. It is further informed that the percentage of total shareholding in 5 joint venture companies is 51% to total shareholding and 33.63% in 1 associate company. The joint venture companies were formed as per mandate given by the empowered Group of Ministers. A copy of the transaction documents entered with strategic partners in case of one of the JVC (hereinafter referred to as ‘ABC Limited’) has been supplied separately by the querist for the perusal of the Committee. The transaction documents of all the 5 JVCs are similar. The financial statements of the Company and associate were consolidated according to line by line method in the financial years 2014-15, 2015-16 and 2016-17. From the financial year 2017-18, CFS are being prepared by consolidation of 5 subsidiaries according to line by line method and 1 associate by equity method.

3. The Audit Committee has desired that opinion by experts from the Institute of Chartered Accountants of India (ICAI) may be obtained to assess the need of consolidation as per the Companies Act and other laws/rules in this regard. The extracts of the meeting at which query was raised by the Audit Committee has also been supplied separately by the querist.

B. Query

4. On the basis of the above, opinion of the Expert Advisory Committee has been sought as to whether consolidation of financial statements of subsidiaries with the Company’s standalone financial statements, in such case where percentage of shareholding is 51% but actual control lies with other partner, has to be done, as being followed by the Company.

C. Points considered by the Committee

5. The Committee notes that the basic issue raised in the query relates to whether the ABC Ltd. and similar such companies in which there is 51% shareholding by the Company but are apparently jointly controlled with other entities, should be considered as subsidiary or

¹ Opinion finalised by the Committee on 18.8.2020.

as joint venture companies and therefore, whether these should be consolidated as per the requirements of Indian Accounting Standard (Ind AS) 110, 'Consolidated Financial Statements' or Ind AS 111, 'Joint Arrangements', notified under the Companies (Indian Accounting Standards) Rules, 2015. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, accounting for transactions between the Company and ABC Ltd. or other shareholders of ABC Ltd., accounting in the books of the Company, accounting for associate company, accounting for prior period item (if any), etc. Further, the Committee has opined purely from accounting perspective and not from any legal perspective, such as, legal interpretation of Memorandum of Understanding (MoU), legal compliance with any Act or Law in force, etc. The Committee also wishes to point out that in the extant case, the query has been considered from the perspective of only one company, ABC Ltd. for which relevant MoU/agreements and other relevant documents have been supplied by the querist and not from the perspective of all the five companies; and whether the opinion expressed hereinafter would be applicable to other companies would depend upon the individual facts and circumstances of each case, considering the terms of the relevant agreements/MoUs etc. Therefore, the opinion should not be generalised to other cases. Furthermore, the Committee wishes to mention that this opinion is based on the specific facts and circumstances of the case and considering specific terms and conditions contained in the MoU/agreement between the parties and thus should not be generalised to other facts and situations. Also, the assessment of control is a continuous exercise and the position may change based on facts and circumstances prevailing. If there is any change or deviation in any terms and conditions in the MoU or agreement, the opinion may not hold good.

6. At the outset, the Committee notes that the Company in the extant case holds 51 per cent shareholding of ABC Ltd. In this regard, the Committee notes that vide Notification G.S.R 680(E) dated 4th September 2015, issued by the Ministry of Corporate Affairs (MCA), the following Rule has been inserted in the Companies (Accounts) Rules, 2014:

“4A. Forms and items contained in financial statements.- The financial statements shall be in the form specified in Schedule III to the Act and comply with Accounting Standards or Indian Accounting Standards as applicable:

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

Further, the Committee notes the following paragraphs from the Guidance Note on Division II-Ind AS Schedule III to the Companies Act, 2013 (Revised July, 2019 Edition)² which states as follows:

“8.1.8.4. ...

The terms ‘subsidiary’, ‘associate’ and ‘joint venture’ shall be as defined in the respective Ind AS. ...”

“8.2.1.16. ...

...The terms ‘subsidiary’ and ‘associate’ should be understood as defined under Ind AS 110 and Ind AS 28. ...”

“12. Part III – General Instructions for Preparation of Consolidated Financial Statements

² The Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 (July 2019 Edition) has been subsequently revised in January 2022.

The Act defines a ‘subsidiary company’ and an ‘associate company’ which is different from the definition of a ‘subsidiary’, an ‘associate’ and a ‘joint venture’ under Ind AS. An amendment to Companies (Accounts) Rules, 2014 on 4 September 2015, newly inserted Rule 4A which state that “*financial statements shall be in the form specified in Schedule III to the Act and comply with Accounting Standards or Indian Accounting Standards as applicable, provided that the items contained in financial statements shall be prepared in accordance with the definitions and other requirements specified in the Accounting Standards or the Indian Accounting Standards, as the case may be.*”

The Act mandates that the companies which have one or more subsidiaries or associates (which as per the Act includes joint ventures) are required to prepare Consolidated Financial Statements (CFS), except under certain circumstances exempted under the Act and Rules.

Accordingly, Ind AS definitions of subsidiary, associate and joint venture shall be considered for assessment of control, joint control and significant influence even though the requirement of preparation of CFS will be governed by the Act.”

From the above, the Committee is of the view that for the purpose of preparation of financial statements, the requirements of Ind ASs have to be considered. Therefore, in the extant case, the term ‘subsidiary’ should be understood as it is defined under Ind AS 110, ‘Consolidated Financial Statements’. In this context, the Committee notes that Appendix A to Ind AS 110 defines ‘subsidiary’ as “an entity that is controlled by another entity”. Thus, the determination of a subsidiary is to be made on the basis of ‘control’ as given in Ind AS 110, and not merely on the basis of shareholding.

7. The Committee further notes the requirements of Ind AS 111, ‘Joint Arrangements’, as follows:

“4 A joint arrangement is an arrangement of which two or more parties have joint control.

5 A joint arrangement has the following characteristics:

(a) The parties are bound by a contractual arrangement (see paragraphs B2–B4).

(b) The contractual arrangement gives two or more of those parties joint control of the arrangement (see paragraphs 7–13).”

“7 Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

8 An entity that is a party to an arrangement shall assess whether the contractual arrangement gives all the parties, or a group of the parties, control of the arrangement collectively. All the parties, or a group of the parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the returns of the arrangement (ie the relevant activities).

9 Once it has been determined that all the parties, or a group of the parties, control the arrangement collectively, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that control the arrangement collectively.”

“12 An entity will need to apply judgement when assessing whether all the parties, or a group of the parties, have joint control of an arrangement. An entity shall make

this assessment by considering all facts and circumstances (see paragraphs B5–B11).”

- “B3 When joint arrangements are structured through a separate vehicle (see paragraphs B19–B33), the contractual arrangement, or some aspects of the contractual arrangement, will in some cases be incorporated in the articles, charter or by-laws of the separate vehicle.”
- “B5 In assessing whether an entity has joint control of an arrangement, an entity shall assess first whether all the parties, or a group of the parties, control the arrangement. Ind AS 110 defines control and shall be used to determine whether all the parties, or a group of the parties, are exposed, or have rights, to variable returns from their involvement with the arrangement and have the ability to affect those returns through their power over the arrangement. When all the parties, or a group of the parties, considered collectively, are able to direct the activities that significantly affect the returns of the arrangement (ie the relevant activities), the parties control the arrangement collectively.
- B6 After concluding that all the parties, or a group of the parties, control the arrangement collectively, an entity shall assess whether it has joint control of the arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement. Assessing whether the arrangement is jointly controlled by all of its parties or by a group of the parties, or controlled by one of its parties alone, can require judgement.
- B7 Sometimes the decision-making process that is agreed upon by the parties in their contractual arrangement implicitly leads to joint control. For example, assume two parties establish an arrangement in which each has 50 per cent of the voting rights and the contractual arrangement between them specifies that at least 51 per cent of the voting rights are required to make decisions about the relevant activities. In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.
- B8 In other circumstances, the contractual arrangement requires a minimum proportion of the voting rights to make decisions about the relevant activities. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the contractual arrangement specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement.

Application examples

Example 1

Assume that three parties establish an arrangement: A has 50 per cent of the voting rights in the arrangement, B has 30 per cent and C has 20 per cent. The contractual arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their contractual arrangement requiring at least 75 per cent of the voting rights to make decisions about the relevant activities imply that A and B have joint control of the

arrangement because decisions about the relevant activities of the arrangement cannot be made without both A and B agreeing.”

- “B9 The requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent. If the requirement for unanimous consent relates only to decisions that give a party protective rights and not to decisions about the relevant activities of an arrangement, that party is not a party with joint control of the arrangement.”

From the above, the Committee notes that in order to determine the nature of arrangement that exists between the parties, it is to be evaluated that whether the arrangement is jointly controlled by all of its parties or by a group of the parties, or controlled by one of the parties (viz., the Company) alone. The Committee also notes that the concept of ‘joint control’ involves concept of ‘control’, which is dealt with in detail in Ind AS 110, ‘Consolidated Financial Statements’. Accordingly, the Committee examines the requirements of Ind AS 110 on the concept of control in the paragraph 8 below.

8. The Committee notes the following paragraphs of Ind AS 110:

- “6 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.

7 Thus, an investor controls an investee if and only if the investor has all the following:

- (a) power over the investee (see paragraphs 10–14);
- (b) exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and
- (c) the ability to use its power over the investee to affect the amount of the investor’s returns (see paragraphs 17 and 18).

8 An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B80–B85).

9 Two or more investors collectively control an investee when they must act together to direct the relevant activities. In such cases, because no investor can direct the activities without the co-operation of the others, no investor individually controls the investee. Each investor would account for its interest in the investee in accordance with the relevant Ind ASs, such as Ind AS 111, *Joint Arrangements*, Ind AS 28, *Investments in Associates and Joint Ventures*, or Ind AS 109, *Financial Instruments*.

Power

10 An investor has power over an investee when the investor has existing rights that give it the current ability to direct the *relevant activities*, ie the activities that significantly affect the investee’s returns.

11 Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be

more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements.”

Further, the Committee notes the following paragraphs from Appendix B of Ind AS 110, reproduced below, which provides application guidance on the requirements of Ind AS 110:

- “B5 When assessing control of an investee, an investor shall consider the purpose and design of the investee in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities.
- B6 When an investee’s purpose and design are considered, it may be clear that an investee is controlled by means of equity instruments that give the holder proportionate voting rights, such as ordinary shares in the investee. In this case, in the absence of any additional arrangements that alter decision-making, the assessment of control focuses on which party, if any, is able to exercise voting rights sufficient to determine the investee’s operating and financing policies (see paragraphs B34–B50). In the most straightforward case, the investor that holds a majority of those voting rights, in the absence of any other factors, controls the investee.”
- “B8 An investee may be designed so that voting rights are not the dominant factor in deciding who controls the investee, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. In such cases, an investor’s consideration of the purpose and design of the investee shall also include consideration of the risks to which the investee was designed to be exposed, the risks it was designed to pass on to the parties involved with the investee and whether the investor is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk, but also the potential for upside.”
- “B11 For many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:
- (a) selling and purchasing of goods or services;
 - (b) managing financial assets during their life (including upon default);
 - (c) selecting, acquiring or disposing of assets;
 - (d) researching and developing new products or processes; and
 - (e) determining a funding structure or obtaining funding.
- B12 Examples of decisions about relevant activities include but are not limited to:
- (a) establishing operating and capital decisions of the investee, including budgets; and
 - (b) appointing and remunerating an investee’s key management personnel or service providers and terminating their services or employment.
- B13 In some situations, activities both before and after a particular set of circumstances arises or event occurs may be relevant activities. When two or more investors have the current ability to direct relevant activities and those activities occur at different times, the investors shall determine which investor is able to direct the activities that most significantly affect those returns consistently with

the treatment of concurrent decision-making rights (see paragraph 13). The investors shall reconsider this assessment over time if relevant facts or circumstances change.”

“B15 Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:

- (a) rights in the form of voting rights (or potential voting rights) of an investee (see paragraphs B34–B50);
- (b) rights to appoint, reassign or remove members of an investee’s key management personnel who have the ability to direct the relevant activities;
- (c) rights to appoint or remove another entity that directs the relevant activities;
- (d) rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and
- (e) other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

B16 Generally, when an investee has a range of operating and financing activities that significantly affect the investee’s returns and when substantive decision-making with respect to these activities is required continuously, it will be voting or similar rights that give an investor power, either individually or in combination with other arrangements.”

“Power with a majority of the voting rights

B35 An investor that holds more than half of the voting rights of an investee has power in the following situations, unless paragraph B36 or paragraph B37 applies:

- (a) the relevant activities are directed by a vote of the holder of the majority of the voting rights, or
- (b) a majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.

Majority of the voting rights but no power

B36 For an investor that holds more than half of the voting rights of an investee, to have power over an investee, the investor’s voting rights must be substantive, in accordance with paragraphs B22–B25, and must provide the investor with the current ability to direct the relevant activities, which often will be through determining operating and financing policies. If another entity has existing rights that provide that entity with the right to direct the relevant activities and that entity is not an agent of the investor, the investor does not have power over the investee.”

From the above, the Committee notes that the assessment of ‘control’ or ‘joint control’ is a matter of judgement and requires periodic assessment, which should be evaluated in the particular facts and circumstances and considering the requirements of any specific contractual arrangement between the parties concerned. In this regard, the Committee notes that the Company, ABC Ltd. and the Strategic Partner (holding 49% shareholding in ABC Ltd.) have entered into a ‘Share Subscription and Shareholders Agreement (SSSA)’, which contains rights and obligations of the Company and Strategic Partner in relation to ABC Ltd.

9. The Committee notes the following clauses from the ‘Share Subscription and Shareholders Agreement (SSSA)’ between the Company, Strategic Partner and ABC Ltd.:

“WHEREAS:

...

- D. Accordingly, for the purposes of setting up a company to act as the joint venture vehicle inter se between ‘the Company’ and the Strategic Partner, which will in turn own, operate and run the textile mill located at ... ‘The Company’ has, prior to the date of execution of this Agreement, incorporated the company (ABC Ltd.), as a special purpose vehicle under the provisions of the Companies Act, 1956, as its wholly owned subsidiary, which will act as the joint venture company inter se between the Company and the Strategic Partner.

...”

“2.2 Compliance with Agreement

The Shareholders agree at all times, to vote and act in a manner so as to fulfill the provisions of this Agreement... The Shareholders shall, at all times, cause its respective nominee(s) as Directors on the Board to act in accordance with this agreement including amending the Articles of Association to conform to this Agreement and causing the company to adopt such amended Articles of Association through the passing of appropriate Board and Shareholder’s resolutions and take other actions as required under applicable law in this regard.”

- “5.1 The Company and the Strategic Partner shall jointly discuss and formulate the capital expenditure plan for the company for the initial Investment Plan for Modernization which shall be for a period of 2 (two) years and for the balance Business Plan period, based on the Business Plan submitted by the Strategic Partner to the Company along with the bid. ...

- 5.2 The Business Plan including Initial Investment Plan for Modernization shall be approved by the Board of Directors of the company. The Strategic Partner shall be solely responsible for the implementation of the Initial Investment Plan for Modernization and the Business Plan to the full satisfaction of the Board of Directors of the company. The company will ensure that the Initial Investment Plan for Modernization and the Business Plan will result in employment generation per se, in the area in which the Mill is located or otherwise. It is clarified that the objective of employment generation at the Mill shall at all times be in sync with textile industry practice / norms prevalent in India. The Strategic Partner hereby undertakes, covenants and confirms to the Company that the principal objective of the Initial Investment Plan for Modernization will be to have the Mill fully operational and running as a commercially viable unit, which process shall in any event be completed within a period of 2 (two) years from the Subscription Date.”

- “5.4 Notwithstanding any other term of this Agreement, the Strategic Partner will be solely responsible for organizing all funds, either in the form of equity and/or shareholder loan and/or third party debt, that will be required for the due implementation of the Business Plan and the Initial Investment Plan for Modernization, to the full satisfaction of the Board of Directors of the company, in accordance with the terms and conditions of this Agreement.

It is hereby clarified that all funds brought in by the Strategic Partner as debt / shareholder loan or procured by the Strategic Partner from a third party lender will at all times have to be on an arms length basis, keeping in view the prevailing bank

rates, which shall be approved by the Board of Directors of the company. It is further clarified that, notwithstanding any other term of this Agreement, as regards any funds that are brought in by the Strategic Partner as debt/shareholder loan in the first 5 (five) years from the Subscription Date, in the manner specified above, the Strategic Partner shall not be permitted under any circumstances whatsoever to swap and/or pull back such funds for a period of at least 5 (five) years from the Subscription Date, subject to the fact that such funds shall be permitted to be repaid by the company to the Strategic Partner through internal accruals in such manner as may be approved by the board of Directors.

It is reiterated that the Company will not be required to bring in any funds, either as equity or as debt / shareholder loan or organize for any funds, in any manner whatsoever, till the completion of 5 (five) years from the Subscription Date.”

“6.1 Constitution of the Board of Directors

- a) On the Subscription Date, the Board of Directors of the company will be reconstituted. Initially, the Board of Directors of the company shall comprise of 8 (Eight) Directors. Unless determined otherwise, the Board of Directors of the company shall have a Board consisting of not more than 12 Directors and a minimum of 6 Directors who shall be nominated as follows:
 - (i) So long as the Company owns not less than 51% of the issued, subscribed and paid up equity share capital of the company:
 - (A) The Company will have the right to appoint a minimum of 5 (Five) Directors on the Board of Directors of the company; and
 - (B) The Company will continue to have the right to appoint the majority of the Board of Directors.
 - (ii) So long as the Strategic Partner owns:
 - (A) not less than 49% of the issued, subscribed and paid up equity share capital of the company, the Strategic Partner will have the right to appoint 3 (Three) Directors on the Board of the Directors of the company;
 - (B) not less than 26% but not more than 49% of the issued, subscribed and paid up equity share capital of the company, the Strategic Partner will have the right to appoint 2 (Two) Directors on the Board of Directors of the company.

In the event the shareholding of the Strategic Partner in the issued, subscribed and paid up share capital of the company falls below 26% for any reason whatsoever, the Strategic Partner will forthwith loose its right to appoint any Directors on the Board of Directors of the company.

- b) All the Directors appointed on the Board of Directors of the company by the Company and the Strategic Partner shall at all times be non-executive Directors.
- c) So long as the Company owns at least 51% of the issued, subscribed and paid up share capital of the company, the Company will have the right to appoint the Chairman of the company. The Chairman shall be a non-executive chairman and will preside at all meetings of the Board and Shareholders of the

company. The Chairman shall have a second casting vote in case of tie in a Board meeting and/or a Shareholder meeting.

- d) The day-to-day functioning, operations and management of the company shall vest with the Chief Executive Officer. The Chief Executive Officer shall be nominated by the Strategic Partner, who shall ideally be a professional with appropriate experience and shall be appointed by the Board of Directors on such terms and conditions as may be deemed fit in this regard. It is clarified that the Chief Executive Officer shall not be a member of the Board of the Directors of the company.
- e) It is hereby agreed that the Shareholders, including the Company and the Strategic Partner shall vote on the Equity Shares held by them in the company to elect / remove the Directors nominated in accordance with this Agreement.
- f) In the event that the Board constitutes a share transfer committee for the purposes of affecting the transfer of Shares of the company, such transfer committee shall include at least one nominee each of the Strategic Partner and the Company.

...”

“6.3 Meetings of the Board

- (a) The Board shall meet at least once every calendar quarter period during the term of this Agreement and in the event that a meeting of the Board is not held during any such quarter period, any Director may call a meeting of the Board on 48 (forty eight) hours prior notice to the other Directors. At each meeting of the Board, unless waived by at least one nominee Director each of the Strategic Partner and the Company, the Chief Executive Officer shall duly report or cause to be reported to the Board with respect to the current status of the operations of the company and with respect to all major developments or planned action involving the company and shall present to the meeting complete current financial information with respect to the company.

...

6.4 Approval of Matters

- (a) Notwithstanding any other provisions of this Agreement or in the Articles of Association or otherwise permitted under the Act, no obligation of the company or any of its subsidiaries shall be entered into, no decision or the determination shall be made and no action shall be taken by or with respect to the company or any of its subsidiaries in relation to the matters identified in **Schedule II**, unless such obligation, decision or action, as the case may be, is approved:
 - (i) If at any meeting of the company's Shareholders duly called for the purpose of considering such obligation, decision or action, then by the affirmative vote of the Company and the Strategic Partner cast at such meeting;
 - (ii) If at any meeting of the Board, then by the affirmative vote of at least one nominee Director of the Company and one nominee Director of the Strategic Partner (or, in the case of Board resolutions by circulation by the approval to such resolution in writing by at least one nominee

Director of the Company and one nominee Director of the Strategic Partner);

It is however clarified that the above right would be available to the Company and/or the Strategic Partner, as the case may be, so long as the Company and the Strategic Partner, as the case may be, each continue to hold at least 49% of the issued, subscribed and paid up share capital of the company.

...

6.5 Chief Executive Officer

- (i) ...The term of the office of the Chief Executive Officer shall be determined by the Board. ...
- (ii) The Chief Executive Officer shall be entrusted with requisite powers of management of the company. The Chief Executive Officer shall function under the direct supervision, control and direction of the Board ...
- (iii) Subject to the provisions of Article 6.4 read with **Schedule II**, the powers and duties of the Chief Executive Officer shall be defined and/or modified from time to time by resolution of the Board, and shall include the powers and duties to, amongst others in accordance with the policy previously approved by the Board.
 - (a) incur capital expenditure and any other operational expenditure and be responsible for preparing and submitting appropriate quarterly reports to the Board of Directors, including on the status of the Initial Investment Plan for Modernization, and issues in relation thereto;
 - (b) appoint and terminate any buyers, suppliers, ancillaries, franchisees and distributors as he/she may deem fit;
 - (c) make decision regarding the marketing of the company's products including fixing of price, margins, discounts and determining the budgets thereof; and
 - (d) take all such actions or execute all such contracts on behalf of the company that are in the ordinary course of business of the company.

6.6 Reporting Requirements

The Chief Executive Officer shall ensure that the company provides to the Board, the Company as well as the Strategic Partner:

...

- (iii) at least 30 (Thirty) days prior to the commencement of a Financial Year, the projections, financial budget and operating plan for the next succeeding three Financial Years and in respect of the first financial year of such succeeding 3 (Three) years a detailed financial budget and...

6.7 Quorum

- (a) The quorum requirement for the Board and Shareholders meeting of the company shall be governed by the provisions of the Act and ...
- (b) Notwithstanding anything to the contrary in Article 6.7(a) above, the presence of at least two Directors or one third of the total number of Director on the Board of the company, whichever is higher, with a minimum of two nominee

Director of the Company and one nominee Director of the Strategic Partner, shall be necessary to constitute quorum in case of Board meeting AND at least one authorised representative each of the Company and the Strategic Partner shall be necessary to constitute quorum in case of general meeting of the Shareholders. A notice of not less than 21 (Twenty One) days shall be given in case of general meeting to the Company and Strategic Partner, unless the Company and Strategic Partner agree to a shorter notice in writing.

...

- (e) Notwithstanding anything to the contrary in Article 6.7(b) above, in the event that the nominee Director of the same Shareholder, whose nominee Director was not present in the meeting referred to in Article 6.7(b) and Article 6.7(c), is not present at the adjourned meeting referred in Article 6.7(d)(i), it shall be deemed that the presence of nominee Director of such Shareholder is not required for such meeting and the Directors present at such adjourned Board shall be entitled to proceed with the items on the agenda in such manner as they deem fit; provided that no decision shall be taken in respect of the matter listed in **Schedule II** without obtaining the affirmative vote of at least one nominee Director of the Company and one nominee Director of the Strategic Partner, as the case may be, in the manner specified in Article 6.4 above.”

SCHEDULE II

MATTER REQUIRING SPECIAL CONSENT

1. Alter the provisions of the Articles of Association.
2. Commence any new line of business other than current or existing line of business.
3. Change of scope of the business of the company.
4. Any decision, including any decision in relation to amending, modifying, revising and/or altering the Business Plan, including the Initial Investment Plan for Modernization.
5. Any decision in regard to the formulation of the employment/human resource policy of the company, including decisions in regard to the number of workers to be appointed at the Mill, salary structures etc and also any decision in regard to appointment of the key management team of the company.
6. Major Capital expenditure plan exceeding Rs 1,00,00,000/- (Rs. One Crore Only) on one project or Rs 5,00,00,000/- (Rs. Five Crores Only) in any given year.
7. Issue further Equity Shares, with or without pre-emptive rights, to members or convert loans or debentures into Equity Shares.
8. Reduction of the Share Capital.
9. Approval of variation of rights of the special classes of shares.
10. Make loans, advances or provide guarantees or security to related parties including the Strategic Partner and Affiliates of the Strategic Partner.
11. Any decision for winding up the company voluntarily.
12. Any buy-back by the company of Equity Shares under the provisions of section 77A of the Act.

13. The granting of any security or creation of any charge, liens or encumbrances, but excluding those necessary to secure operating lines of credit/working capital requirements of the company with institutional investors, multilateral agencies, scheduled banks and financial institutions.
14. Any one or a series of transactions which causes a sale, right to use, sub-lease, lease, transfer, assign, exchange or disposition of property or assets of the company or its subsidiary having an aggregate value exceeding 5% of gross block of each class of fixed assets of the company.
15. Any one, or a series of transactions which causes a sale, transfer, assign, exchange or disposition of the land (leasehold/freehold) of the company or its subsidiary.
16. Any decision to invest by the company in any one or more of the group companies or Affiliates of the Strategic Partner and/or granting loans to, or provision of guarantees or security to other any one or more of the group companies or Affiliates of the Strategic Partner.
17. Any proposal, scheme, arrangement or agreement for restructuring of the company or any of its businesses through a process of merger, demerges, subsidiarisation and amalgamation.
18. Any inter party or related party transaction having a value exceeding Rs. 10,00,000/- (Rs. Ten Lakhs Only) in aggregate, in any one Financial Year.
19. Any decision in regard to granting a sub-lease of the leasehold rights granted in favour of the company by the Company in respect of the Surplus Land in accordance with the terms and conditions of the Lease Deed.
20. Any commitment or agreement to do any of the foregoing.

The Committee notes from the above that the purpose of incorporation of ABC Ltd. appears to be to establish a special purpose vehicle, which is intended to act as a joint venture company of the Company and the Strategic Partner.

Also, as per clause 5.2 of SSSA, the Strategic Partner shall be solely responsible for the implementation of the Initial Investment Plan for Modernisation and the Business Plan to the full satisfaction of the Board of Directors of the company. As per clause 5.4 of SSSA, the Strategic Partner will be solely responsible for organising all funds, either in the form of equity and/or shareholder loan and/or third party debt, that will be required for due implementation of the Business Plan and the Initial Investment Plan for modernization, to the full satisfaction of the Board of Directors of the company, in accordance with the terms and conditions of the Agreement.

The Committee also notes that as per clause 6.1 (a) of SSSA, the Board of Directors of ABC Ltd. shall comprise of 8 directors and the company will appoint minimum of 5 directors and has the right to appoint the majority of the Board of Directors; as per clause 6.1 (c), the Company also has the right to appoint the Chairman of ABC Ltd. who will preside at all the meetings of the Board and shareholders of ABC Ltd. and has a second casting vote in case of tie in a Board meeting and/or a shareholders' meeting. The Committee also notes that clause 6.7 (b) regarding quorum states that the presence of at least two directors or one third of the total number of directors on the board of the company (ABC Ltd.), whichever is higher, with a minimum of two nominee directors of the Company shall be necessary to constitute quorum in case of Board meeting and at least one authorised representative of the Company shall be necessary to constitute quorum in case of general meeting of the Shareholders. Further, since

the Company holds 51% shareholding in ABC Ltd., it may be argued that the Company has the ability to 'control' ABC Ltd.

However, the Committee notes that as per Clause 6.7(e) of SSSA, reproduced above, in respect of the matters listed in Schedule II, no decision shall be taken without obtaining the affirmative vote of at least one nominee Director of the Company and one nominee Director of the Strategic Partner. The matters listed in Schedule II includes matters related to commencement of any new line of business, change of scope of business, major capital expenditure exceeding rupees one crore, appointment of key management team of ABC Ltd., any decision in relation to amending, modifying, revising and/or altering the Business Plan, including the Initial Investment Plan for Modernization, issue of further equity shares, etc. The Committee also notes that clause 6.1 (a) of SSSA states that the Strategic Partner has the right to appoint 3 directors as long as it owns not less than 49% of the equity share capital of the company. Further, as per clause 6.5, the chief executive officer of ABC Ltd., who shall have the authority to manage the entire business and day-to-day operations and management of the company (ABC Ltd.) shall be nominated by the Strategic Partner, which although shall be appointed by the Board of Directors of the company. Furthermore, clause 6.7 (b) regarding quorum states that the presence of at least one nominee Director of the Strategic Partner (apart from the nominee directors of 'the Company' as afore-mentioned) shall be necessary to constitute quorum in case of Board meeting and at least one authorised representative of the Strategic Partner (apart from the authorised representative of 'the Company' as afore-mentioned) shall be necessary to constitute quorum in case of general meeting of the Shareholders.

Accordingly, considering these matters and other rights in the extant case; the intent with which the joint venture company was set up; the terms of the SSSA entered into with the Strategic Partner; the fact that the Strategic Partner was solely responsible for organising all funds for the purpose of modernization and implementation of Business Plan; and considering that the Strategic Partner holds not less than 49% equity shareholding in ABC Ltd., the Committee is of the view that these activities are in the nature of relevant activities as per the requirements of Ind AS 110 reproduced above and therefore, shall entitle both the parties to the Share Subscription and Shareholders Agreement, 'joint control' over ABC Ltd. Thus, in spite of the majority shareholding, the Company will not be able to take the decisions about the relevant activities of the company unilaterally. Accordingly, the Committee is of the view that ABC Ltd. is not a subsidiary of the Company; rather is a joint arrangement. Therefore, the Company should not do line by line consolidation of the financial statements of ABC Ltd.; rather should account for the joint arrangement as per the requirements of Ind AS 111.

10. Incidentally, the Committee wishes to point out that considering the requirements of the Companies Act, 2013 and the applicable accounting standards, the Company is required to prepare consolidated financial statements for its joint ventures, as per 'equity method' of accounting in accordance with Ind AS 28, 'Investments in Associates and Joint Ventures' even if it does not have subsidiaries.

D. Opinion

11. On the basis of the above and subject to paragraph 5 above, the Committee is of the opinion that ABC Ltd. in the extant case is not a subsidiary of the Company. The said arrangement is to be considered as a Joint Arrangement and accordingly should be accounted for as per the requirements of Ind AS 111, as discussed in paragraph 9 above.