

Query No. 26

Subject: Classification of an entity as subsidiary or joint venture and consolidation thereof.¹

A. Facts of the Case

1. A State Government Company (hereinafter referred to as 'the Company') in which the State Government is holding 99.99% shares is engaged in mining and selling of rock phosphate, gypsum, limestone and lignite. Its mines are located at different places in the State. The State Government Company is also having wind power mills and solar plant installed in one of the districts of the State.

2. The Company is having net worth of more than Rs. 500.00 crore and is required to adopt Indian Accounting Standards (Ind AS) and accordingly, the Company has adopted Ind AS in accordance with the Notification dated 16th February 2015 issued by the Ministry of Corporate Affairs (MCA), Government of India, with effect from 1st April 2016 with transition date as 1st April 2015.

3. The Government of India (GOI), vide its letter dated 13.11.2006, has allocated coal blocks in certain lignite mines in favour of the Company for mining of lignite in the State. As per the condition mentioned in the allotment letter, 'in principle' approval for the mining rights was given to the Company for carrying out the lignite mining either by the Company or a separate company to be created with participation of the Company provided that the separate company created is a Government company eligible to do mining as per the provisions of Coal Mines (Nationalisation) Act, 1983.

4. In view of the above, the Company has entered into a Joint Venture (JV) Agreement on 27.12.2006 with a private company, A Ltd. to form a Joint Venture Company (JVC) in which the Company shall be holding 51% equity shares. As per the JV Agreement, A Ltd. should make all the investments and the Company shall have no financial liability with respect to the JVC. (A copy of the JV Agreement has been supplied separately by the querist for the perusal of the Committee.)

5. As per the terms and conditions of JV Agreement, the Company should obtain mining lease of the lignite mines in reference from the State Government and transfer the same to the JVC. The Company should also obtain all necessary licenses/consents/approvals from the Government and regulatory approvals/consents from the Central as well as the State Government for use, operation, development and management of the mines. As per the terms of the Agreement, all the expenses incurred /to be incurred by the Company shall be borne by the JVC/A Ltd. After transfer of mining leases in favour of JVC, the lignite mines would be developed and operated by JVC/A Ltd. and the lignite to be mined from the mines is to be consumed by the private company for power generation by lignite based power plant to be established by A Ltd.

6. The authorised, issued and subscribed capital of the JV Company of Rs. 20.00 crore having 2.00 crore shares of Rs. 10.00 per share. The Company is holding 1.02 crore shares of Rs. 10.00 each while 0.98 crore shares of Rs. 10.00 each is being hold by A Ltd. According to the querist, as the Company holds 51% of shares of the JVC, it is a subsidiary of the

¹ Opinion finalised by the Committee on 23.12.2021.

Company. Based on the above, the consolidation of the Company with JVC was done on the basis of line by line basis since financial year 2016-17 and was consistently carried out.

7. While conducting supplementary audit for the financial year 2019-20, the Auditor General (AG) has observed that Appendix A to Indian Accounting Standard (Ind AS) 110, 'Consolidated Financial Statements' 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. 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 Consolidated Financial Statements (CFS) will be governed by the Act. Auditor observed that in spite of shareholding, since for taking decisions in the matters of the JV company, as per the JV Agreement, the exercise of voting by the Director nominated by A Ltd. is also essential, the Company cannot take important decisions about the relevant activities of the JVC unilaterally. Therefore, the Company cannot be considered as controlling the activities of the JVC, unilaterally. Accordingly, the JVC is not a subsidiary of the Company, rather is a joint arrangement and therefore, the Company, should not do line-by-line consolidation of the financial statements of the JVC rather should consider it as a joint arrangement and accordingly, account for the same as per the requirements of Ind AS 111.

8. The auditors have observed the following basis and also noticed that assessment of 'control' or 'joint control' should be evaluated after considering the requirements of any specific contractual arrangement between the parties concerned. In this regard, important clauses of the Joint Venture Agreement entered between A Ltd. and the Company are as under:

- The day-to-day management of the JVC shall be delegated to a Managing Director, nominated by A Ltd. No amendment or reduction of powers shall be valid without the prior unanimous consent of A Ltd. and the Company.
- No business at any meeting including adjourned meetings of the Board shall be transacted unless at least one Director of A Ltd. and One Company's Director are present at commencement of such meeting and throughout its proceedings.
- Voting at Board Meetings shall require approval of at least one Director of A Ltd. and One Company's Director.
- No resolution shall be deemed to have been duly passed by the Board or a Committee thereof by circulation unless the resolution has been circulated in draft, together with the necessary papers, if any to all directors or to all members of the committee, and to all other directors or members at their usual address, and has been approved by a majority of such of them as are entitled to vote on the resolution having one Director of A Ltd. and one Company's Director.

9. Based on this, the AG has concluded that the consolidation made by the Company on line to line basis was not in order.

10. On the observation made by audit, the Company has opined that the consolidation made by the Company on line by line basis was in order. In support of this, the Company has submitted that as per clause 5.1 of the Joint Venture Agreement entered between the Company and A Ltd. on 27 December, 2006, the composition of the Board of JVC would be as under:

- The Board shall be composed of 7 Directors, 3 appointed by each, the Company and A Ltd., irrespective of shareholding pattern, One Director, who shall be the chairman of the Board, shall be appointed by the State Government in terms of Clause 5.4 (I).
- As per clause no. 5.5.1 of the Agreement, the day-to-day management of the JV Company shall be delegated to a Managing Director nominated by A Ltd. who shall exercise such powers as may be delegated to him/her by the Board subject to its overall control, direction and supervision.

Here “its” means Board in which 4 Directors out of the total 7 Directors are from the Company/State Government, thus, effectively the day-to-day management is being controlled by the Board in which majority of Directors are from the Company/State Government including Chairman of the Company.

- Further, the Chairman shall have a casting vote at any meeting of the Board or any committee there of or at any General meeting in the event of an equality of votes as per clause no. 5.4 (iii) of the JV Agreement.

From the above, according to the querist, it is very clear that the Company is not only holding 51% shares in JVC but also, is controlling the affairs of JVC, through the Board of 7 Directors in which 4 Directors are from the Company/State Government (which is owning almost 100% shares of the Company), including the Chairman of JVC, having a casting vote also.

11. However, the AG auditor observed the issue that the method of consolidation in case of JVC, i.e., line-by-line basis is not correct and directed that opinion should be sought from the Institute of Chartered Accountant of India (ICAI).

B. Query

12. In view of the facts mentioned above, the querist has sought the opinion of the Expert Advisory Committee of the ICAI regarding the method to be followed for consolidation of the financial statements of JVC in the consolidated financial statements of the Company.

C. Points considered by the Committee

13. The Committee notes that the basic issue raised in the query relates to whether the Joint Venture Company in the extant case, in which the Company holds 51% shareholding, should be considered as subsidiary or as a joint venture and therefore, whether it 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 A Ltd. or the Company with JVC, accounting in the separate financial statements of the 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 Joint Venture Agreement, Implementation Agreement, Memorandum of Association (MoA), Articles of Association (AoA), legal compliance with any Act or Law in force, etc. The Committee also wishes to point out that this opinion is based on the specific facts and circumstances of the case and considering specific terms and conditions contained in the 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 if the

relevant facts and circumstances change. Furthermore, if there is any change or deviation in any terms and conditions in the Agreement, the opinion may not hold good.

14. At the outset, the Committee notes that the Company in the extant case holds 51 per cent shareholding of JVC. 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, issued by the ICAI, 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

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.”

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.

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.

15. 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.

B4 The contractual arrangement sets out the terms upon which the parties participate in the activity that is the subject of the arrangement. The contractual arrangement generally deals with such matters as:

(a) the purpose, activity and duration of the joint arrangement.

- (b) how the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed.
- (c) the decision-making process: the matters requiring decisions from the parties, the voting rights of the parties and the required level of support for those matters. The decision-making process reflected in the contractual arrangement establishes joint control of the arrangement (see paragraphs B5–B11).
- (d) the capital or other contributions required of the parties.
- (e) how the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement.

Joint control (paragraphs 7-13)

- 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 both the parties, or controlled by one of the parties (viz., the Company) alone. Further, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement.

16. 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 as follows:

- “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 and A Ltd. have entered into a ‘Joint Venture Agreement’, which contains rights and obligations of the Company and A Ltd. in relation to JVC.

17. The Committee now examines the following clauses from the ‘Joint Venture Agreement’ between the Company and A Ltd.:

“(C) State Government and **A Ltd.** have entered into an Implementation Agreement dated May 29, 2006 (the “Implementation Agreement”) under which, the State Government has agreed to provide support for the Project in accordance with the terms and conditions described therein. The Implementation Agreement provides, *inter alia*:

- (i) **A Ltd.** shall form a joint venture company with the Company (the “**Mining Entity**”) for mining lignite from the deposits at the Mines.
- (ii) State Government shall grant to the Mining Entity all consents, permits, approvals, mining lease, concessions, registrations, permissions within its purview as required by the Mining Entity to undertake to establish, operate and maintain the Project.
- (iii) State Government, after prior approval of GOI shall grant the mining leases for the Mines to the Company and shall provide the Mining Entity (to which such leases shall be transferred with the prior approval of GOI) all consents, permissions (whether statutory or non-statutory), within its purview and as required by the Mining Entity to develop, establish, open, operate and maintain the Mines.
- (iv) State Government agrees that **A Ltd.** and/or its consortium member shall be responsible for the development, management and operation of the Mines as it has the requisite expertise to do so.”

“3.2 The Company shall and undertakes to take all actions necessary or required to:

- (i) Obtain the mining leases for the Mines from the State Government and transfer the same to the JV Company;

- (ii) Obtain all the necessary licenses, government and regulatory approvals and consents, including without limitation the approval of the Government of India and/or the approval of the State Government, for the use, operation, development and management of the Mines all of which shall be valid and existing during the term of this Agreement;
- (iii) Obtain all government and regulatory approvals and consents including the approval from GOI/State Government for the transfer of all its rights including surface rights under the mining licenses with respect to the use, operation, development and management of the Mines to the JV Company;

...

All the expenses incurred/to be incurred by the Company under this Agreement including but not limited to expenses with respect to (i), (ii) and (iii) above shall be borne by the JV Company/**A Ltd.**

3.3 **A Ltd.** shall and undertakes to:

- (i) *make all investments in the JV Company and agrees that the Company shall have no financial liability with respect to the JV Company including for holding 51% Equity Shares in the JV Company at all points of time;*

...

- (iv) in case the Mining Project is abandoned, take all necessary formalities as may be required to wind up the JV Company. In case any liability is actually fastened on the Company due to winding up of the JV Company as aforesaid, **A Ltd.** shall discharge/make good such liability;

...”

“5.1 **Board Composition**

- (i) The Board shall be composed of 7 (seven) Directors, 3 (three) Directors appointed by each, the Company and A Ltd., irrespective of the Shareholding Pattern. One Director, who shall also be the Chairman of the Board, shall be appointed by the State Government in terms of Clause 5.4(i).

...

5.4 **Chairman**

- (i) The Chairman of the Board of Directors would be nominated by the Chief Secretary, State Government.
- (ii) The Chairman shall preside at all meetings of the Board or any committee thereof where he/she is a member and at all General Meetings. In the absence of the Chairman for any reason whatsoever at a meeting of the Board or any committee thereof where he/she is a member, or any General Meeting, the Directors present shall choose one of the Company Directors to be the Chairman of the meeting.

- (iii) The Chairman shall have a casting vote at any meeting of the Board or any committee thereof or at any General Meeting in the event of an equality of votes.

...

5.5 Managing Director

5.5.1 The day-to-day management of the JV Company shall be delegated to a Managing Director, nominated by A Ltd. who shall exercise such powers as may be delegated to him/ her by the Board subject to its overall control, direction and supervision.

5.5.2 The Managing Director shall be responsible for the day-to-day management of the JV Company including compliance with all statutory requirements and shall have exclusive authority to decide on all matters as listed in Schedule - I.

...

5.5.4 The powers, functions and duties of the Managing Director as stated in Section herein shall be suitably incorporated into the Articles and Memorandum of Association of the JV Company.

5.5.5 The Managing Director shall report all material actions undertaken, or proposed to be undertaken, by him in the exercise of powers delegated to him by the Board at their meetings.

5.5.6 The Company agrees that they shall not take any action, assist or approve any action, including without limitation, passing a resolution in the board of the JV Company or by amending the memorandum or articles of association of the JV Company, to amend or reduce the powers of the Managing Directors as set out in this Agreement and no amendment or reduction of powers shall be valid without the prior unanimous consent of A Ltd. and the Company in writing.”

“5.7 Quorum at meetings of the Board

(i) The quorum for a meeting of the Board, duly convened and held, shall be one third of the total number of Directors or 2 (two) Directors, whichever shall be higher provided however that no quorum as aforesaid shall be validly constituted, and no business at any meeting, including adjourned meetings, of the Board shall be transacted, unless at least 1 (one) A Ltd. Director and 1 (one) Company’s Director is present at the commencement of such meeting and throughout its proceedings.

(ii) In the absence of a valid quorum at a meeting of the Board, duly convened, the meeting shall be adjourned to the same day in the next week at the same time and place or to such other date and such other time and place as the members present in such meeting may determine.

(iii) ...Every committee of the Board so constituted shall however include at least 1 (one) A Ltd. Director and 1 (one) Company’s Director. No quorum at any meeting of such committee shall be validly constituted unless at least 1 (one) A Ltd. Director and 1 (one) Company’s Director is present at the commencement of such meeting and throughout its proceedings.

5.8 Voting at Board Meetings

Each Director present at a meeting shall have one vote in respect of decisions to be made by the Board and all decisions of the Board shall be carried by a majority vote of those present (in person) and voting shall require approval of at least 1 (one) A Ltd. Director and 1 (one) Company's Director (in person and voting).

5.9 Resolution by Circulation

No resolution shall be deemed to have been duly passed by the Board or a committee thereof by Circulation, unless the resolution has been circulated in draft, together with the necessary papers, if any to all Directors or to all members of the committee, and to all other Directors or members at their usual address, and has been approved by a majority of such of them as are entitled to vote on the resolution having at least 1 (one) A Ltd. Director and 1 (one) Company's Director.

5.10 General Meetings

...

(iii) ... No business shall be transacted at any General Meeting duly convened and held other than that specified in the notice without the prior written consent of the shareholders of the JV company.

(iv) The quorum for a General Meeting shall be at least 5 (five) members which must include 1 (one) representative of the A Ltd. and 1 (one) representative of the Company.

...

(viii) At a General Meeting all resolutions shall be carried only by (i) a majority vote and (ii) the affirmative vote of A Ltd. and the Company as a shareholder."

“5.12 Amendment to Memorandum and Articles

The Company and A Ltd. shall ensure that the Memorandum and the Articles of Association of JV Company incorporate the provisions of this Agreement...”

“Schedule – I

Matters to be decided by the Managing Director

1. Day to day management of the JV Company.
2. Matters relating to compliance with all statutory and legal requirements including Government directives regarding the same.
3. All matters relating to fuel supply agreement for and the supply of lignite from Mines to the Power Plants.
4. *All matters pertaining to the mining operation and extraction of Lignite from the Mines* and transportation of lignite to the Power Plant with emphasis on safety and security of men, machinery and property.

5. *All matters relating to the mining lease and the mine development and exploitation plan for the Mines.*
6. All matters relating to the obligations of the Mining Entity under the Implementation Agreement dated May 29, 2006 between the State Government and A Ltd. or any other agreement.
7. All matters relating to consents, permits, approvals, mining lease, concessions, registrations, permissions, deployment of manpower, contract management including power to represent and negotiate on behalf of JV Company within its purview as required by the Mining Entity to undertake to establish, operate and maintain the Project.
8. Issue of the shares as per agreed shareholding pattern in this agreement.
9. *All financial matters relating to the Project.*
10. Defense and prosecution/filing of legal matters on behalf of the JV Company. ”

(Emphasis supplied by the Committee.)

18. The Committee notes from the above that the purpose of incorporation of JVC is mining lignite from the deposits at the mines, wherein the Company shall obtain the mining leases for mines and transfer the same to JVC, shall obtain necessary licenses, government and regulatory approvals/licenses/permissions etc. for the operations of JVC. Whereas A Ltd. will be responsible for development, management and operation of mines as it has the requisite expertise.

As per clause 5.1 (i) of the JV Agreement, the Board of Directors of the JVC shall be composed of 7 directors, 3 each appointed by the Company and A Ltd. (*irrespective of their shareholding pattern*) and 1 Director who will also be the Chairman of the Board shall be appointed by State Government. Clause 5.4 further states that in the absence of the Chairman for any reason whatsoever at a meeting of the Board or any committee thereof, where he/she is a member, or any General Meeting, the Directors present shall choose one of the Company's Directors to be the Chairman of the meeting and the Chairman shall have a casting vote in the event of an equality of votes.

With regard to Quorum at the Board meeting, the Committee notes that as per clause 5.7(i), at least 1 Director of A Ltd. and 1 Company's Director are required to be present at the commencement of the Board meeting and throughout its proceedings. Further, with regard to the voting, as per clause 5.8, although each Director present at a meeting shall have one vote in respect of decisions to be made by the Board and all decisions of the Board shall be carried by a majority vote of those present (in person), however, voting shall require *approval of at least 1 A Ltd. Director* and 1 Company's Director (in person and voting). Thus, without the approval or consent of one of the Directors of A Ltd., no decision can be taken at the meetings of the Board. Further, although the Chairman of the Board, who shall be either nominated by the State Government or the Company (in the absence of Chairman nominated by the state Government is absent at the meeting) has a casting vote at the board meeting, since decision of the Board require approval of atleast one of the Director of A Ltd., the decisions about relevant activities cannot be taken unilaterally by the Company. Moreover, even at the General Meetings of the JV company, although all resolutions shall be carried by a majority vote, the affirmative vote of A Ltd. and the Company as shareholder is required,

which further corroborates the fact the decisions about the activities of the JV company cannot be taken by the Company unilaterally.

Further, the Committee notes that Clause 5.5 states that the day-to-day management of the JV Company shall be delegated to a Managing Director (MD), nominated by A Ltd. who shall exercise such powers as may be delegated by the Board subject to its overall control, direction and supervision. The MD as per the JV Agreement shall be acting as the chief executive officer of the JV company and shall be responsible for the day-to-day management of the JV Company including compliance with all statutory requirements and shall have exclusive authority to decide on all matters as listed in Schedule - I. It has further been agreed that the powers of the MD cannot be amended or reduced without the prior unanimous consent of A Ltd. and the Company in writing. The Committee notes that the activities listed in Schedule I covers major operating and financial activities of JVC, which may be considered as relevant activities as per the requirements of Ind AS 110 and 111. Further, in this context, the Committee also notes that although the Managing Director would exercise its powers under the overall control of the Board which comprises of equal directors of both the parties, however, the scope of powers of MD nominated by A Ltd. cannot be changed or reduced without the approval of A Ltd.

The Committee further notes from the Implementation Agreement between the State Government and A Ltd. that A Ltd. has been selected by the State Government for setting up of lignite mining cum thermal power projects in the State. Further, the Project shall have two separate components; (i) Mining Component, which means the part of the Project comprising facilities and infrastructure relating to lignite mining and (ii) Power Component, which means the part of the Project comprising the Power Plant and all related infrastructure facilities for setting up of Power Plant using lignite as primary fuel. Implementation Agreement further states that the Company shall form a separate mining entity for carrying out lignite mining for the mining component of the Project for which State Government shall ensure the transfer of mining lease for the Mines in favour of the mining entity after getting approval from the GOI. It also states that a JV Company shall be formed between the Company and A Ltd. in which the Company would hold 26% equity and 74% equity would be held by A Ltd. Mining lease will be transferred to this JV company after obtaining prior approval of the GOI. However, if GOI does not permit transfer of the lease to the JV company as proposed above, then the Company will hold 51% equity in the JV company and the mining lease will be transferred to this JV company after seeking prior approval of GOI and all investment will be made by A Ltd. with no financial liability on the Company. Further, the JV company would enter into an exclusive fuel supply agreement with A Ltd. for a period of 30 years for supply of lignite from the mines for the power project, and shall also enter into an exclusive and irrevocable mining contract with A Ltd./its consortium members for the development, opening and extraction of lignite from the mines.

From the above, it appears that the intent of the State Government is setting up of lignite mining cum thermal power projects in the State through A Ltd. and not to control the activities of JV company (considering the proposed structure of equity of 26% by the Company and 74% by A Ltd. provided the GOI permits transfer of the mining lease to the JV company with such equity structure). Thus, the Committee is of the view that it is only for the purpose of controlling mining lease and not the activities of the JV company as such, that the equity stake of the Company in joint venture company has been increased. Further, the Committee is of the view that although the State Government may be holding almost entire equity of the Company, merely by virtue of this fact, it should not be considered that the Director nominated by the State Government, who is also Chairman of the Board shall always agree or

consent to the decisions of the Company. In other words, that Director/Chairman should be considered as independent, having his own views.

The Committee also notes from the example given in paragraph B7 of Ind AS 111 that where in the arrangement it has been agreed upon that decision about the relevant activities cannot be made without both parties agreeing, then parties have implicitly agreed that they have joint control. Accordingly, considering the requirements of Ind AS 110 and 111, the terms of the JV Agreement entered between the Company and A Ltd., implementation agreement, etc., the Committee is of the view that in the extant case, in spite of the majority shareholding, the Company will not be able to take the decisions about the relevant activities of the JV company unilaterally; rather the decisions about the relevant activities are taken unanimously by both the parties, viz., the Company and A Ltd. Accordingly, the Committee is of the view that JVC 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 the JVC; rather should account for the joint arrangement as per the requirements of Ind AS 111.

D. Opinion

19. In view of above, the Committee is of the view that JVC 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 18 above.
