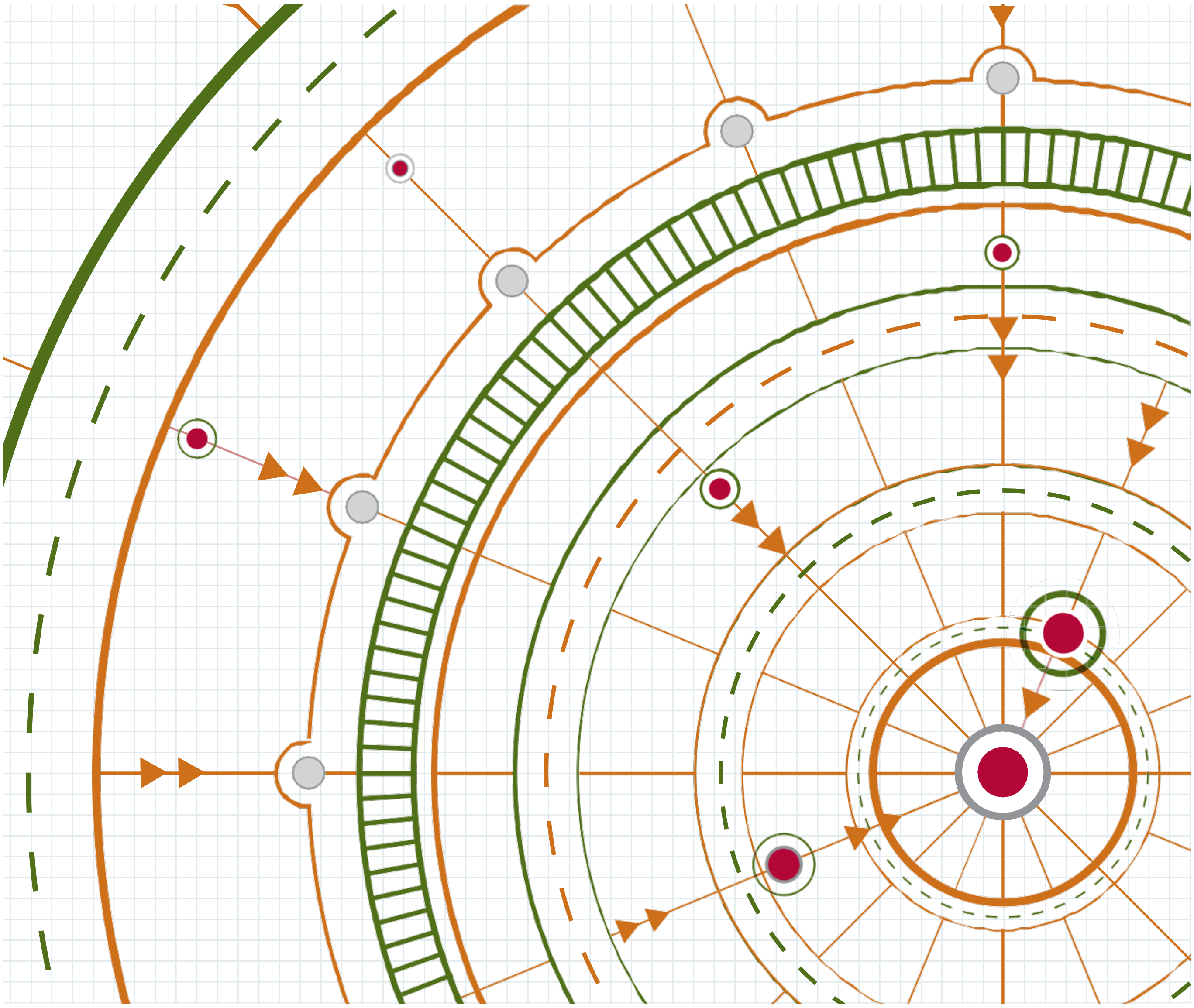
IFRS for SMEs® Standard (2015) + Q&As

IFRS® Foundation—Supporting Material for the *IFRS for SMEs* Standard

Module 9—Consolidated and Separate Financial Statements



IFRS®

IFRS® Foundation Supporting Material for the *IFRS for SMEs*® Standard

including the full text of
Section 9 *Consolidated and Separate Financial Statements*
of the *IFRS for SMEs* Standard
issued by the International Accounting Standards Board in October 2015

with extensive explanations, self-assessment questions and case studies

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Module 9—Consolidated and Separate Financial Statements

The accounting requirements applicable to small and medium-sized entities (SMEs) discussed in this module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.
This module has been prepared by IFRS Foundation education staff.
The contents of Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* Standard (Glossary) is also part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 9. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

INTRODUCTION

Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the IFRS for SMEs* Standard.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

This module

This module focuses on the general requirements for presenting financial statements applying Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Standard.
It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance understanding of the requirements. The module identifies the significant judgements required in preparing consolidated and separate financial statements. In addition, the module includes questions designed to test your understanding of the requirements and case studies that provide a practical opportunity to apply the requirements to prepare consolidated and separate financial statements applying the *IFRS for SMEs* Standard.

Module 9—Consolidated and Separate Financial Statements

Upon successful completion of this module, you should, within the context of the *IFRS for SMEs* Standard, be able to:

- identify parent-subsidiary relationships (identify control relationships, including those in the form of special purpose entities);
- identify when a parent entity is required to present consolidated financial statements;
- prepare consolidated financial statements;
- account for investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of the parent, if any;
- prepare combined financial statements, if any; and
- identify the disclosures that are required to be made in consolidated, separate and combined financial statements.

IFRS for SMEs Standard

The *IFRS for SMEs* Standard is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

In the *IFRS for SMEs* Standard, Appendix A: Effective date and transition, and Appendix B: Glossary of terms, are part of the mandatory requirements.

In the *IFRS for SMEs* Standard, there are appendices to Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* These appendices provide non-mandatory guidance.

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as 'questions and answers' (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (January 2019) the SMEIG has not issued any Q&As relevant to this module.

Module 9—Consolidated and Separate Financial Statements

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

The objective of Section 9 *Consolidated and Separate Financial Statements* is to prescribe when consolidated financial statements should be presented and to prescribe the financial reporting requirements for preparing consolidated, separate and combined financial statements.

Consolidated financial statements

The fundamental principle of consolidated financial statements is that they should present financial information about a group (a parent and its subsidiaries) as those of a single economic entity.

Except in the very limited circumstances set out in paragraphs 9.3 and 9.3C, the *IFRS for SMEs* Standard requires a parent entity to present consolidated financial statements.

Identifying a subsidiary often requires significant judgement, especially in cases where the voting rights of a parent over what would be its subsidiary is not more than half. The Glossary of terms of the *IFRS for SMEs* Standard (the Glossary) defines a subsidiary as an 'entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).'

Separate financial statements

The *IFRS for SMEs* Standard does not require separate financial statements to be presented.

However, when separate financial statements are prepared, Section 9 requires an entity to account for its investments in subsidiaries, jointly controlled entities and associates in those financial statements after adopting one of the following accounting policies: cost less impairment; fair value with changes recognised in profit or loss; or the equity method.

Combined financial statements

The *IFRS for SMEs* Standard does not require combined financial statements to be presented.

The fundamental principle of combined financial statements is that they present financial information about two or more entities that are under common control.

Module 9—Consolidated and Separate Financial Statements

What has changed since the 2009 *IFRS for SMEs* Standard?

The following are the main changes made to Section 9 by the 2015 Amendments:

- clarification that a subsidiary acquired and held with the intention of sale or disposal within one year is excluded from consolidation; and the addition of guidance on how a subsidiary of that kind is accounted for, together with a requirement to disclose the carrying amount of investments in such subsidiaries (see paragraphs 9.3–9.3C and 9.23A);
- addition of guidance on the preparation of consolidated financial statements if group entities have different reporting dates (see paragraph 9.16);
- clarification that cumulative exchange differences that arise from the translation of a foreign subsidiary are not recognised in profit or loss on the disposal of the subsidiary (this amendment was based on the SMEIG Q&A 2012/04 *Recycling of cumulative exchange differences on disposal of a subsidiary*) (see paragraph 9.18);
- addition of an option to permit an entity to account for investments in subsidiaries, associates and jointly controlled entities in its separate financial statements using the equity method; and clarification of the definition of separate financial statements (this amendment was based on *Equity Method in Separate Financial Statements* (Amendments to IAS 27) issued in August 2014) (see paragraphs 9.24–9.26 and the related definition in the Glossary); and
- modification to the definition of combined financial statements to refer to entities under common control, instead of only those under common control by a single investor (see paragraph 9.28 and the deletion of the definition from the Glossary).

In addition, consequential changes were made to paragraphs 9.1–9.2 relating to the changes to Section 1; these changes confirm that if a parent entity by itself does not have public accountability, it may present its separate financial statements in accordance with the *IFRS for SMEs* Standard, even if it presents its consolidated financial statements in accordance with full IFRS Standards or another set of generally accepted accounting principles, such as its national accounting standards (see paragraph 1.7 of Section 1 *Small and Medium-sized Entities*).

All the changes are covered in this module, including editorial changes.

Module 9—Consolidated and Separate Financial Statements

REQUIREMENTS AND EXAMPLES

Scope of this section

9.1 This section defines the circumstances in which an entity applying this Standard presents **consolidated financial statements** and the procedures for preparing those statements in accordance with this Standard. It also includes guidance on **separate financial statements** and **combined financial statements** if they are prepared in accordance with this Standard. If a **parent** entity by itself does not have **public accountability**, it may present its separate financial statements in accordance with this Standard, even if it presents its consolidated financial statements in accordance with **full IFRS** or another set of generally accepted accounting principles (GAAP).

Notes

The Glossary of terms of the *IFRS for SMEs* Standard (the Glossary) defines consolidated financial statements as the 'financial statements of a parent and its subsidiaries presented as those of a single economic entity.'

Separate financial statements are 'a second set of financial statements presented by an entity' (see paragraph 9.25), in which the entity could elect, under paragraph 9.26, to account for its investments in subsidiaries, jointly-controlled entities and associates either at cost less impairment; at fair value with changes in fair value recognised in profit or loss; or using the equity method following the procedures in paragraph 14.8. For example, a parent with two subsidiaries will prepare consolidated financial statements applying Section 9 (unless it is exempt by paragraph 9.3 or 9.3C) and, if it also prepares separate financial statements, it may choose to account for those subsidiaries in its separate financial statements at cost less impairment, at fair value or using the equity method.

Combined financial statements are a single set of financial statements of two or more entities under common control. In other words, the combined financial statements present financial information about entities that are controlled by the same investor (or investors), as if those entities were a single entity. For example, an individual may own all of the issued share capital of three entities and may wish to produce financial statements combining the results and assets of the three entities as if the entities were a single entity.

Module 9—Consolidated and Separate Financial Statements

Requirement to present consolidated financial statements

9.2 Except as permitted or required by paragraphs 9.3 and 9.3C, a parent entity shall present consolidated financial statements in which it consolidates its investments in **subsidiaries**. Consolidated financial statements shall include all subsidiaries of the parent.

9.3 A parent need not present consolidated financial statements if both of the following conditions are met:

(a) the parent is itself a subsidiary; and

(b) its ultimate parent (or any intermediate parent) produces consolidated **general purpose financial statements** that comply with full IFRS or with this Standard.

Note

The Glossary defines a parent as 'an entity that has one or more subsidiaries.' Whereas a subsidiary is defined by the Glossary as an entity 'that is controlled by another entity (known as the parent).' Furthermore, a subsidiary includes an unincorporated entity such as a partnership.

Examples—no exemption from consolidated financial statements

Ex 1 **Entity B has a subsidiary, Entity C. Entity B's immediate and ultimate parent is Entity A. Entities A, B and C do not have public accountability. Entities A, B and C produce general purpose financial statements; Entities B and C do so in compliance with the *IFRS for SMEs* Standard while Entity A presents consolidated financial statements in compliance with local GAAP (a GAAP required or permitted in the jurisdiction in which Entity A reports, which is neither full IFRS Standards nor the *IFRS for SMEs* Standard).**

Entity B is required to present consolidated financial statements in compliance with the *IFRS for SMEs* Standard because Entity A (its parent and ultimate parent) does not prepare consolidated general purpose financial statements in compliance with either full IFRS Standards or the *IFRS for SMEs* Standard.

Ex 2 **Entity B has a subsidiary, Entity C. Entity B is owned by Entity A. Entity A does not prepare financial statements because the jurisdiction in which it is registered and operates does not require the preparation of financial statements. Entity B produces general purpose financial statements in compliance with the *IFRS for SMEs* Standard.**

Entity B is required to present consolidated financial statements in compliance with the *IFRS for SMEs* Standard because its parent (or ultimate parent) does not prepare consolidated general purpose financial statements in compliance with either full IFRS Standards or the *IFRS for SMEs* Standard.

Examples—exempt from presenting consolidated financial statements

Ex 3 **Entity B has a subsidiary, Entity C. Entity B's immediate and ultimate parent is Entity A.**

Entities A, B and C do not have public accountability. They produce general purpose financial statements in compliance with the *IFRS for SMEs* Standard. Consequently, Entity A presents consolidated financial statements.

Entity B is not required to present consolidated financial statements because Entity A, its ultimate parent, presents consolidated general purpose financial statements in compliance with the *IFRS for SMEs* Standard.

Ex 4 **The facts are the same as in Example 3. However, in this example, Entity A has public accountability and is therefore unable to apply the *IFRS for SMEs* Standard; instead it applies full IFRS Standards. Accordingly, Entity A produces consolidated general purpose financial statements in compliance with full IFRS Standards.**

Entity B is not required to present consolidated financial statements because Entity A, its ultimate parent, presents consolidated general purpose financial statements in compliance with full IFRS Standards.

Ex 5 **Entity C has a subsidiary, Entity D. Entity C's parent is Entity B and Entity B's parent is Entity A.**

Entities A, B, C and D do not have public accountability. They produce general purpose financial statements; Entities B, C and D do so in compliance with the *IFRS for SMEs* Standard and Entity A presents consolidated financial statements in compliance with local GAAP.

Entity C is not required to present consolidated financial statements because its immediate parent (Entity B) presents consolidated general purpose financial statements in compliance with the *IFRS for SMEs* Standard. As explained in Example 1, Entity B is required to present consolidated financial statements in compliance with the *IFRS for SMEs* Standard because it does not have a parent that presents consolidated general purpose financial statements in compliance with either full IFRS Standards or the *IFRS for SMEs* Standard.

Ex 6 **Entity C has a subsidiary, Entity D. Entity C's parent is Entity B and Entity B's immediate and ultimate parent is Entity A.**

Entities A, B, C and D do not have public accountability. They produce general purpose financial statements; Entities A, C and D do so in compliance with the *IFRS for SMEs* Standard and Entity B does so in compliance with local GAAP (a GAAP required or permitted in the jurisdiction in which Entity B reports, which is neither full IFRS Standards nor the *IFRS for SMEs* Standard).

Entity C is not required to present consolidated financial statements because its ultimate parent (Entity A) presents consolidated general purpose financial statements in compliance with the *IFRS for SMEs* Standard.

Ex 7 **Entity B has a subsidiary, Entity C. Entity B is 70% owned by Entity A with the remaining shares held by three individuals.**

Entities A, B and C do not have public accountability. They produce general purpose financial statements in compliance with the *IFRS for SMEs* Standard.

Entity B is not required to present consolidated financial statements, because its ultimate parent (Entity A) prepares consolidated general purpose financial statements in compliance with the *IFRS for SMEs* Standard. It does not matter that Entity B is not wholly owned by its parent, Entity A.

9.3A Subject to paragraph 9.3B, a subsidiary is not consolidated if it is acquired and is held with the intention of selling or disposing of it within one year from its acquisition date (ie the date on which the acquirer obtains **control** of the acquiree). Such a subsidiary is accounted for in accordance with the requirements in Section 11 *Basic Financial Instruments* as for investments in paragraph 11.8(d), instead of in accordance with this section. The parent shall also provide the disclosure in paragraph 9.23A.

9.3B If a subsidiary previously excluded from consolidation in accordance with paragraph 9.3A is not disposed of within one year from its acquisition date (ie the parent entity still has control over that subsidiary):

(a) the parent shall consolidate the subsidiary from the acquisition date unless it meets the condition in paragraph 9.3B(b). Consequently, if the acquisition date was in a prior period, the relevant prior periods shall be restated.

(b) if the delay is caused by events or circumstances beyond the parent's control and there is sufficient evidence at the **reporting date** that the parent remains committed to its plan to sell or dispose of the subsidiary, the parent shall continue to account for the subsidiary in accordance with paragraph 9.3A.

9.3C If a parent has no subsidiaries other than subsidiaries that are not required to be consolidated in accordance with paragraphs 9.3A–9.3B, it shall not present consolidated financial statements. However, the parent shall provide the disclosure in paragraph 9.23A.

Notes

A subsidiary is not consolidated by a parent entity if it is both acquired and held with the intention of selling or disposing of it within one year from its acquisition date. This exemption requires the parent to have the intent to sell the subsidiary on acquisition. The exemption does not apply if the parent acquires a subsidiary intending to keep it, but then, due to unforeseen circumstances, at a later date the parent decides to sell the subsidiary within the year.

Consolidated financial statements are not required if an entity has no subsidiaries other than those acquired and held with the intention of being sold or disposed of within one year from their acquisition date..

Examples—subsidiary held with the intention of sale or disposal within one year from its acquisition date

Ex 8 **Entity A acquired Entity B with the intention of selling it within six months of the acquisition date. Entity A has no other subsidiaries.**

Entity A is not required to present consolidated financial statements in compliance with the *IFRS for SMEs* Standard. If the fair value of Entity B's shares can be determined reliably without undue cost or effort, Applying Section 11 *Basic Financial Instruments*, Entity A accounts for its investment at fair value with changes in fair value recognised in profit or loss. Otherwise, Entity A accounts for its investment at cost less impairment (see paragraphs 11.8(d) and 11.14(c).

If Entity A had other subsidiaries, it would present consolidated financial statements in compliance with the *IFRS for SMEs* Standard. In those consolidated financial statements it would, as above, account for its investment in Entity B at fair value with changes in fair value recognised in profit or loss.

Ex 9 **Entity A acquires Entity B. Entity B has three subsidiaries: C, D and E. Upon acquisition of Entity B, Entity A does not intend to keep Entity E. Entity A actively looks for a purchaser and expects to sell Entity E within a year of acquisition of Entity B.**

Entity A is not required to consolidate Entity E. Instead, Entity E is measured by applying Section 11:

(a) at fair value, with changes in fair value recognised in profit or loss, if fair value can be measured reliably without undue cost or effort; or

(b) at cost less impairment, if fair value cannot be measured reliably without undue cost or effort.

See Module 11 for a discussion of when the fair value of equity instruments cannot be measured reliably without undue cost or effort.

If Entity A has no intention to dispose of the other subsidiaries (Entities B, C and D), it is still required to prepare consolidated financial statements. Entity A's consolidated financial statements will include entities B, C and D.

9.4 A subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. If an entity has created a special purpose entity (SPE) to accomplish a narrow and well-defined objective, the entity shall consolidate the SPE when the substance of the relationship indicates that the SPE is controlled by that entity (see paragraphs 9.10–9.12).

Notes

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent). The definition of control, set out in the Glossary, can be split into two parts: first, the power to govern the financial and operating policies of an entity; which, second, is exercised so as to obtain benefits from the entity's activities.

Control is not based on legal ownership and can be passive; it is the ability to control, not necessarily the exercise of control. A parent may own no shares in an entity (such as certain special purpose entities (SPEs)) and yet still control the entity. In the absence of an ownership interest, benefits might be obtained by the parent from, for example, cross-selling opportunities or cost savings.

Only one entity can control another entity at a point in time. It is necessary to analyse all relevant facts and circumstances in order to establish which entity, if any, has control of another entity.

9.5 Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity. That presumption may be overcome in exceptional circumstances if it can be clearly demonstrated that such ownership does not constitute control. Control also exists when the parent owns half or less of the voting power of an entity but it has:

(a) power over more than half of the voting rights by virtue of an agreement with other investors;

(b) power to govern the financial and operating policies of the entity under a statute or an agreement;

(c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or

(d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

Notes

In addition to the situations described in paragraph 9.5, other facts and circumstances may indicate a relationship in which an entity controls another entity or SPE and consequently must consolidate the entity or SPE. (See further paragraph 9.11 for a non-exhaustive list of circumstances that may indicate that an entity controls an SPE.)

Examples—control of another entity

Ex 10 **Entity A owns all of the ordinary shares, to which voting rights are attached, of Entity B. All ordinary shares in Entity B carry equal voting rights.**

Entity A has control over more than half of the voting power in Entity B and, in the absence of evidence to the contrary, Entity A controls Entity B. Entity A is the parent of Entity B (its subsidiary).[1]

Ex 11 **Entity A owns 60% of the ordinary shares, to which voting rights are attached, of Entity B. All ordinary shares in Entity B carry equal voting rights.**

Entity A has control over more than half of the voting power in Entity B and, in the absence of evidence to the contrary, Entity A controls Entity B. Entity A is the parent of Entity B (its subsidiary).

[1] In this example, and in all other examples in this module, all relevant facts and circumstances must be considered when evaluating whether one entity controls another.

Ex 12 **Entity A owns 60% of the ordinary shares, to which voting rights are attached, of Entity B.**

Entity B owns 70% of the ordinary shares, to which voting rights are attached, of Entity C.

All ordinary shares in both entities carry equal voting rights.

Entity B has control over more than half of the voting power in Entity C and, in the absence of evidence to the contrary, Entity B controls Entity C. Entity B is the parent of Entity C (its subsidiary).

Entity A has direct control over more than half of the voting power in Entity B and indirect control over Entity C through its subsidiary, Entity B. In the absence of evidence to the contrary, Entity A controls Entities B and C. Entity A is the parent of Entity B and the ultimate parent of Entity C. Entity B and Entity C are subsidiaries of Entity A.

Ex 13 **Entity A owns 40% of the ordinary shares, to which voting rights are attached, of Entity B. Furthermore, a shareholder owning 15% of the ordinary shares of Entity B has ceded its voting rights to Entity A. All ordinary shares in Entity B carry equal voting rights.**

Entity A has control over more than half of the voting power in Entity B (40% direct control + 15% as a result of the cession of voting rights to the entity = 55%). In the absence of evidence to the contrary, Entity A controls Entity B. Entity A is the parent of Entity B (its subsidiary).

Ex 14 **Entity A owns 40% of the ordinary shares, to which voting rights are attached, of Entity B. The government of the country in which Entities A and B are registered and operate has granted Entity A in law the sole right to determine the financial and operating policies of Entity B.**

Entity A has control over Entity B, because it has power to govern the financial and operating policies of Entity B. Entity A is the parent of Entity B (its subsidiary).

Ex 15 **Entity A owns 40% of the ordinary shares, to which voting rights are attached, of Entity B. Entity A has the right to appoint and remove the majority of the members of the board of directors of Entity B. Each member of the board of directors has equal voting rights in meetings of the board.**

Through the ability to appoint and remove the majority of the board of directors, Entity A has control over the financial and operating policies of Entity B. In the absence of evidence to the contrary, Entity A controls Entity B. Entity A is the parent of Entity B (its subsidiary).

Ex 16 **Entities A and B enter into a partnership in which each partner has an equal interest in the profit or loss generated by the partnership. The voting arrangements of the partnership are structured in such a way that 60% of the voting rights in the partnership are held by Entity A.**

Entity A has control over more than half of the voting power in the partnership. In the absence of evidence to the contrary, Entity A controls the partnership. Only one entity can control the partnership, so, if Entity A controls it Entity B cannot do so. Entity A is the parent of the partnership (its subsidiary). The ratio in which profits are to be shared between the partners is generally not relevant for determining control.

Ex 17 **Entity A owns 45% of the ordinary shares, to which voting rights are attached, of Entity B. It also has the right to appoint the majority of the members of the board of directors of Entity B by applying special rights given to Entity A in the founding document of Entity B.**

Entity A controls Entity B. Through its right to appoint the majority of the members of the board of directors it has the power to govern Entity B's financial and operating policies. Entity A controls Entity B even though it owns less than half of the voting power of Entity B.

Ex 18 **Entity A owns 65% of the ordinary shares, to which voting rights are attached, of Entity B. Entity B has been placed into administration and a third-party entity has been appointed by the court to run Entity B.**

Despite Entity A's shareholding in Entity B being greater than 50%, Entity A does not control Entity B, because of the court's appointment of an administrator for Entity B. Before being placed in administration, Entity B would have been controlled by Entity A (in the absence of evidence to the contrary) and Entity B would have been a subsidiary of Entity A until that time.

Ex 19 **Entity A owns 65% of the ordinary shares, to which voting rights are attached, of Entity B. Entity B's financial and operating policies are governed by its board of directors. Entity B operates in an industry that is highly regulated by government agencies. In the jurisdiction in which Entity B operates, the government agencies have the power to appoint directors that hold more than half of the voting power of the entity's board of directors.**

Despite Entity A's shareholding in Entity B being greater than 50%, the government agencies' power over the entity means that, effectively, Entity B is controlled by the government agencies and not by Entity A. This would be so even if the government agencies had not intervened in any way in the running of Entity B. However, if Entity B operated in a highly regulated industry with significantly curtailed operating freedom, rather than in circumstances where the government agencies have the power to appoint directors with more than half the voting power, Entity B might still be controlled by Entity A. This could be the case if Entity A obtains, or can obtain, benefits from decision-making powers that give it power over Entity B. For example, if Entity B operates in a highly regulated electricity market, regulators might determine the amount of electricity Entity B can supply, when it can supply it, and the price it will receive for it, but not have the power to appoint any directors. Entity A's board of directors could retain the power to govern the financial and operating policies of Entity B, making decisions about, for example, Entity B's cost structure, whether to continue in the industry, and any ancillary activities Entity B chooses to engage in. If this is the case and Entity A has the power to appoint the majority of the members of the board, Entity A would have power over Entity B, and therefore would control Entity B.

9.6 Control can also be achieved by having options or convertible instruments that are currently exercisable or by having an agent with the ability to direct the activities for the benefit of the controlling entity.

Notes

An entity may own some share warrants in another entity, either alone or together with some ordinary shares in that other entity. If the share warrants are ignored, the first entity may not control the second entity. However, if the share warrants were exercised this may result in the first entity controlling the second entity. If exercising the share warrants would give the first entity control of the second entity, holding the warrants would give the first entity the ability to control the second entity, but only if the warrants were immediately exercisable. Accordingly, the *IFRS for SMEs* Standard requires that the existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by another entity, must be considered when assessing whether an entity has the power to govern the financial and operating policies of another entity. In addition to share warrants, potential voting rights include share call options, debt or equity instruments that are convertible into ordinary shares. Other similar instruments that have the potential, if exercised or converted, to give the entity voting power (or reduce another party's voting power) over the financial and operating policies of another entity are also potential voting rights.

The existence of potential voting rights does not affect a parent entity's share in the net profit or loss of the subsidiary. The profit or loss (including each component of other comprehensive income when applicable) of the subsidiary as part of the consolidated net income is attributed to the owners of the parent and to the non-controlling interest based on present ownership interest (see paragraph 9.22).

Examples—control of another entity: potential voting rights

Ex 20 **Entity A owns 30% of the ordinary shares, to which voting rights are attached, of Entity B.**

Entity A also holds currently exercisable options to acquire shares in Entity B that, if exercised, would increase Entity A's votes in Entity B to 70%.

Entity A has the ability to control more than half of the voting power in Entity B (70%) because at any point it could choose to exercise the options. In the absence of evidence to the contrary, Entity A controls Entity B. Entity A is the parent of Entity B (its subsidiary).

Ex 21 **Entity A owns 55% of the ordinary shares, to which voting rights are attached, of Entity D. Entity B owns 20% and Entity C owns 25%. Entities B and C are independent third parties.**

Entity B also holds currently exercisable share warrants in Entity D that, if exercised, would increase Entity B's votes in Entity D to 60% and would dilute Entity A's holding to 27.5% of Entity D.

Because the warrants are currently exercisable, Entity B has the ability to control more than half of the voting power in Entity D (60%). In the absence of evidence to the contrary, Entity B controls Entity D. Entity B is the parent of Entity D (its subsidiary).

Ex 22 **Entity A owns 35% of the ordinary shares, to which voting rights are attached, of Entity D. Entity B owns 30% and Entity C owns 35%. Entities B and C are independent third parties.**

Entity A also holds currently exercisable call options to acquire the shares in Entity D that are owned by Entity B and Entity C.

Entity A has the ability to control more than half of the voting power in Entity D because at any point it could choose to exercise the call options. In the absence of evidence to the contrary, Entity A controls Entity D. Entity A is the parent of Entity D (its subsidiary); this is so even if the management of Entity A does not intend to exercise the call options (IAS 27(2008) IG8 Example 4).

9.7 A subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation or similar entity.

Notes

Venture capital organisations make money by owning equity in the companies in which they invest (start-up firms and small businesses with the potential for future growth). Venture capital organisations also often provide managerial and technical expertise. Raising capital from such organisations is especially attractive to new companies with a limited operating history, and to companies which cannot raise funds by issuing debt or by bank loans.

Examples—consolidation of subsidiaries owned by venture capital organisations

Ex 23 **Entity A, a well-known portfolio manager, invests in entities with high growth potential, which operate in industries that are characterised by high technological risk. Entity A aims to profit primarily from their capital growth.**

Entity A acquires 65% of the ordinary shares, to which voting rights are attached, of Entity B. Entity B is currently developing business intelligence software for retailing companies.

In the absence of evidence to the contrary, Entity A controls Entity B. Entity A can govern the strategic operating and financing policies of Entity B and can benefit through its 65% ownership interest. Entity A must therefore include Entity B in its consolidated financial statements.

Ex 24 **Entity A finances emerging clean-energy technology businesses with commercial potential. In particular, it makes early-stage investments to accelerate the commercialisation of those businesses in which it invests. Entity A holds more than 50% of the ordinary shares, which carry voting rights at a general meeting of shareholders, in seven entities. Each entity operates in a different country.**

In the absence of evidence to the contrary, Entity A controls all seven entities. Entity A can govern the strategic operating and financing policies of all those entities and can benefit through its ownership interests. A subsidiary cannot be excluded from consolidation simply because the investor is a venture capital organisation. Accordingly, Entity A must include all seven entities in its consolidated financial statements.

9.8 A subsidiary is not excluded from consolidation because its business activities are dissimilar to those of the other entities within the consolidation. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries.

Example—consolidation of subsidiaries with dissimilar business activities

Ex 25 **Entity A manufactures motor vehicles. It has two subsidiaries—one provides bridge-construction services and the other is a bakery.**

Entity A is required to consolidate both its bridge construction and its bakery subsidiaries with its motor-vehicle manufacturing operations in its consolidated financial statements.

9.9 A subsidiary is not excluded from consolidation because it operates in a jurisdiction that imposes restrictions on transferring **cash** or other **assets** out of the jurisdiction.

Example—consolidation of subsidiaries operating in a jurisdiction where transfer of assets out of it is restricted

Ex 26 **Entity A is located and operates in Country X. Entity A holds all of the ordinary shares, to which voting rights are attached, of Entity B and it controls Entity B. Entity B operates in Country Z. Country Z has foreign exchange control regulations that restrict the repatriation of profits to foreign shareholders. The restriction limits transfers of cash or other assets out of the country to a maximum of 10% of profits for the year.**

Entity A is required to consolidate Entity B. The restriction on transferring cash does not, when considered in isolation, deny Entity A control over its subsidiary (Entity B).

Special purpose entities

9.10 An entity may be created to accomplish a narrow objective (for example, to effect a **lease**, undertake **research** and **development** activities or securitise **financial assets**). Such an SPE may take the form of a corporation, trust, partnership or unincorporated entity. Often, SPEs are created with legal arrangements that impose strict requirements over the operations of the SPE.

Notes

An SPE (sometimes called a special purpose vehicle (SPV)) is an entity created to fulfil narrow, specific or temporary objectives. Common reasons for creating SPEs include:

- Securitisation—SPEs are commonly used to securitise loans (or other receivables).
- Risk-sharing—corporate entities sometimes use SPEs to isolate a high-risk project/asset from the parent company.
- Asset transfer—SPEs are sometimes used to facilitate the ownership and transfer of assets and related components (such as permits relating to the asset) where, because of complex legal or regulatory reasons, transfer of ownership of the SPE is easier than transfer of the asset and its related components.
- Regulatory reasons—an SPE is sometimes set up to circumvent regulatory restrictions, such as regulations relating to the nationality of the owners of specific assets.
- If the substance of the relationship indicates that an SPE is controlled by an entity, paragraph 9.4 requires that the entity must consolidate that SPE.

9.11 An entity shall prepare consolidated financial statements that include the entity and any SPEs that are controlled by that entity. In addition to the circumstances described in paragraph 9.5, the following circumstances may indicate that an entity controls an SPE (this is not an exhaustive list):

(a) the activities of the SPE are being conducted on behalf of the entity according to its specific business needs;

(b) the entity has the ultimate decision-making powers over the activities of the SPE even if the day-to-day decisions have been delegated;

(c) the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; or

(d) the entity retains the majority of the residual or ownership risks related to the SPE or its assets.

9.12 Paragraphs 9.10 and 9.11 do not apply to **post-employment benefit plans** or other long-term **employee benefit** plans to which Section 28 *Employee Benefits* applies.

Example—consolidation of an SPE

Ex 27 **Entity A, a pharmaceutical manufacturer, established a research centre at a local university. Entity A determined that the sole and unalterable purpose of the research centre is to research and develop immunisations against and cures for viruses that cause human suffering.**

The research centre is owned by the university and staffed by its foremost virologists.

All costs of establishing and running the research centre, including all equipment, staff costs and materials, are paid from the proceeds of a grant from Entity A. The budget for the research centre is approved by Entity A yearly in advance.

Entity A benefits from the research centre by association with the prestigious university and through the exclusive right to patent any immunisations and cures developed at the research centre.

The research centre is a ‘special purpose entity’ controlled by Entity A. Although Entity A owns none of the research centre’s equity, it controls the research centre by predetermining the activities of the research centre and approving its funding each year (satisfying the control criterion) and benefits through its exclusive right to patent any immunisations and cures developed at the research centre (satisfying the benefit criterion).

Module 9—Consolidated and Separate Financial Statements

Consolidation procedures

9.13 The consolidated financial statements present financial information about the **group** as a single economic entity. In preparing consolidated financial statements, an entity shall:

(a) combine the **financial statements** of the parent and its subsidiaries line by line by adding together like items of assets, **liabilities**, **equity**, **income** and **expenses**.

(b) eliminate the **carrying amount** of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary.

(c) measure and present **non-controlling interest** in the **profit or loss** of consolidated subsidiaries for the **reporting period** separately from the interest of the **owners** of the parent.

(d) measure and present non-controlling interest in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them. Non-controlling interest in the net assets consists of:

(i) the amount of the non-controlling interest at the date of the original combination calculated in accordance with Section 19 *Business Combinations and Goodwill*; and

(ii) the non-controlling interest's share of changes in equity since the date of the combination.

Examples—consolidation procedures

Ex 28 **On 31 December 20X0 Entity A acquired all of the ordinary shares, which carry voting rights at a general meeting of shareholders, of Entity B for CU6,000[2] in cash; and it controlled Entity B from that date. The acquisition-date statements of financial position of Entities A and B and the fair values of the assets and liabilities recognised on Entity B's statement of financial position were:[3]**

	Entity A	Entity B	
	Carrying amount CU	*Carrying amount CU*	*Fair value CU*
Assets			
Non-current assets			
Building and other PPE	7,000	3,000	3,300
Investment in Entity B	6,000		
	13,000	3,000	
Current assets			
Inventories	700	500	600
Trade receivables	300	250	250
Cash	1,500	700	700
	2,500	1,450	
Total assets	**15,500**	**4,450**	

(2) In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units' (CU).

(3) In this example, and in all other examples in this module (unless specified otherwise), income tax has been ignored.

Equity and liabilities			
Equity			
Share capital	5,000	2,000	
Retained earnings	10,200	2,300	
	15,200	**4,300**	
Current liabilities			
Trade payables	300	150	150
	300	150	
Total liabilities and equity	**15,500**	**4,450**	

Entity A's consolidated statement of financial position at 31 December 20X0 will be calculated as follows:

Column: A	**B**	**C**	**D**	**E**
	Entity A	**Entity B**	**Consolidation adjustments**	**Consolidated** *(Column B + Column C + Column D)*
	Carrying amount	*Carrying amount*		
	CU	*CU*	*CU*	*CU*
Assets				
Non-current assets				
Goodwill	-	-	1,300 (a)	1,300
Buildings and other PPE	7,000	3,000	300	10,300
Investment in Entity B	6,000	-	(6,000)	-
	13,000	3,000		11,600
Current assets				
Inventories	700	500	100	1,300
Trade receivables	300	250		550
Cash	1,500	700		2,200
	2,500	1,450		4,050
Total assets	**15,500**	**4,450**		**15,650**
Equity and liabilities				
Equity				
Share capital	5,000	2,000	(2,000)	5,000
Reserves	10,200	2,300	(2,300)	10,200
Total equity	**15,200**	**4,300**		**15,200**
Current liabilities				
Trade payables	300	150		450
	300	150		450
Total liabilities and equity	**15,500**	**4,450**		**15,650**

Consolidation involves:

- adding the statement of financial position of the parent and its subsidiary (columns B and C) together line by line in accordance with paragraph 9.13(a).
- applying paragraph 9.13(b), eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets acquired, liabilities and contingent liabilities assumed); and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased).
- recognising the fair value adjustments together with the goodwill that arose on acquisition of the subsidiary.

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X0 are set out below (these have been presented in column D on the previous page):

Consolidation adjustments	*CU*	*CU*
Dr Asset—goodwill	1,300[(a)]	
Dr Asset—buildings and other PPE	300	
Dr Asset—inventories	100	
Dr Equity—share capital (Entity B)	2,000	
Dr Equity—retained earnings (Entity B)	2,300	
Cr Asset—Investment in Entity B (Entity A)		6,000

To eliminate the carrying amount of the parent's investment in its subsidiary and the equity of the subsidiary at the date of acquisition and to recognise the fair value adjustments and goodwill arising on the business combination.

[(a)] Working for goodwill:

Consideration paid, cost of business combination	CU6,000
Fair value of identifiable net assets acquired CU4,850 acquisition date fair value of assets of acquiree (Entity B) (CU3,300 buildings and other PPE + CU600 inventories + CU250 trade receivables + CU700 cash) minus CU150 fair value of trade payables	4,700
Goodwill	CU1,300

Ex 29 **The facts are the same as in Example 28. At 31 December 20X1, one year after Entity A acquired Entity B, the individual statements of financial position and statements of comprehensive income of Entities A and B are:**

Statements of financial position at 31 December 20X1:

	Entity A *Carrying amount* *CU*	**Entity B** *Carrying amount* *CU*
Assets		
Non-current assets		
Building and other PPE	6,500	2,750
Investment in Entity B	6,000	-
	12,500	2,750
Current assets		
Inventories	800	550
Trade receivables	380	300
Cash	2,670	1,420
	3,850	2,270
Total assets	**16,350**	**5,020**
Equity and liabilities		
Equity		
Share capital	5,000	2,000
Retained earnings	11,000	2,850
	16,000	4,850
Current liabilities		
Trade payables	350	170
	350	170
Total liabilities and equity	**16,350**	**5,020**

Statements of comprehensive income for the year ended 31 December 20X1:

	Entity A *CU*	**Entity B** *CU*
Revenue	3,000	1,900
Cost of sales	(1,800)	(1,000)
Gross profit	**1,200**	**900**
Administrative expenses	(400)	(350)
Profit for the year	**800**	**550**

Note: Management's best estimate of the useful life of the goodwill is ten years. Entity A uses the straight-line amortisation method for goodwill. The fair value adjustment to buildings and other PPE is in respect of a building; all buildings have an estimated remaining useful life of 20 years from 31 December 20X0 and estimated residual values of zero. Entity A uses the straight-line method for depreciation of PPE. All of the inventory held by Entity B at 31 December 20X0 was sold to a third party during 20X1.

Entity A's consolidated statement of comprehensive income for the year ended 31 December 20X1 will be computed as follows:

	Entity A	Entity B	Consolidation adjustments		Consolidated
	CU	*CU*	*CU*		*CU*
Revenue	3,000	1,900			4,900
Cost of sales	(1,800)	(1,000)	(100)	(a)	(2,900)
Gross profit	**1,200**	**900**			**2,000**
Administrative expenses	(400)	(350)	(145)	(b)	(895)
Profit for the year	**800**	**550**			**1,105**

Consolidation involves:

- adding the statement of comprehensive income of the parent and its subsidiary together line by line, in accordance with paragraph 9.13(a).
- recognising the fair value adjustments and/or amortisation thereof together with amortisation of the goodwill asset that arose on acquisition of the subsidiary—see the consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X1 set out below.

Entity A's consolidated statement of financial position at 31 December 20X1 will be computed as follows:

	Entity A	Entity B	Consolidation adjustments		Consolidated
	Carrying amount CU	*Carrying amount CU*	*CU*		*CU*
Assets					
Non-current assets					
Goodwill	-	-	1,170	(c)	1,170
Buildings and other PPE	6,500	2,750	285	(d)	9,535
Investment in Entity B	6,000	-	(6,000)		-
	12,500	2,750			10,705
Current assets					
Inventories	800	550			1,350
Trade receivables	380	300			680
Cash	2,670	1,420			4,090
	3,850	2,270			6,120
Total assets	**16,350**	**5,020**			**16,825**
Equity and liabilities					
Equity					
Share capital	5,000	2,000	(2,000)		5,000
Reserves	11,000	2,850	(2,545)	(e)	11,305
	16,000	4,850			16,305
Current liabilities					
Trade payables	350	170			520
	350	170			520
Total liabilities and equity	**16,350**	**5,020**			**16,825**

Module 9—Consolidated and Separate Financial Statements

Consolidation involves:

- adding the statement of financial position of the parent and its subsidiary together line by line, in accordance with paragraph 9.13(a);
- applying paragraph 9.13(b), eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets acquired, and liabilities and contingent liabilities assumed); and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased); and
- recognising the fair value adjustments together with the goodwill that arose on acquisition of the subsidiary, as adjusted to reflect the first year post-acquisition.

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X1, and the related workings, are set out below.

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X1 are:

1. Repeat of acquisition date consolidation adjustment:

	CU	*CU*
Dr Asset—goodwill	1,300	
Dr Asset—buildings and other PPE	300	
Dr Asset—inventories	100	
Dr Equity—share capital (Entity B)	2,000	
Dr Equity—retained earnings (Entity B)	2,300	
Cr Asset—investment in Entity B (Entity A)		6,000

To eliminate the carrying amount of the parent's investment in its subsidiary and the equity in the subsidiary at the date of acquisition and to recognise the fair value adjustments and goodwill arising on the business combination.

2. Recognition of amortisation of goodwill and fair value adjustment in respect of Entity B's building:

	CU	*CU*
Dr Equity—retained earnings (Group): profit or loss 20X1—administrative expenses*	145	
Cr Asset—goodwill		130[(c)]
Cr Asset—buildings and other PPE		15[(d)]

To recognise the amortisation of goodwill and the additional depreciation required in respect of the fair value adjustment to the carrying amount of the subsidiary's building in the consolidated financial statements for the year ended 31 December 20X1.

* Although this consolidation adjustment is to retained earnings in the statement of financial position, the adjustment is via the consolidated statement of comprehensive income.

3. Elimination of inventory fair value adjustment following the sale of all the inventory during the year:

	CU	*CU*
Dr Equity—retained earnings (Group): profit or loss 20X1—cost of sales*	100	
Cr Asset—inventories		100

To eliminate the fair value adjustment to inventory following the sale, during the year ended 31 December 20X1, of all the inventory as at 31 December 20X0.

* Although this consolidation adjustment is to retained earnings in the statement of financial position, the adjustment is via the consolidated statement of comprehensive income. For simplicity it is assumed that all the goodwill amortisation and the additional buildings depreciation is adjusted against administrative expenses.

(a) Cost of sales adjustment:

CU100 = fair value adjustment in respect of inventories at 31 December 20X0.

(b) Administrative expenses adjustment:

CU145 = Amortisation of goodwill CU130(c) + additional depreciation on building CU15.(d)

(c) Working for goodwill:

Goodwill at the acquisition date, CU1,300, minus accumulated amortisation, which this year is amortisation for one year, CU130 (CU1,300 ÷ 10 years) = CU1,170.

(d) Working for building consolidation adjustment:

The fair value adjustment at 31 December 20X0 in respect of Entity B's building was CU300, that is, the carrying amount in Entity B's financial statements at 31 December 20X0 was CU300 lower than was recognised in the group's consolidated statement of financial position. The building is being depreciated over 20 years from 31 December 20X0. Thus at 31 December 20X1 the adjustment required on consolidation to the statement of financial position will be CU285, being CU300 × 19/20 years' estimated useful life remaining. The additional depreciation recognised in the consolidated statement of comprehensive income is CU15 (being CU300 x 1/20).

(e) Reserves adjustment:

CU2,300 adjustment at the acquisition date (see Example 28) plus CU130(c) amortisation of goodwill plus CU15(d) additional depreciation on building plus CU100(a) fair value adjustment in respect of inventories = CU2,545.

Notes—non-controlling interest

The Glossary provides that a non-controlling interest (NCI) is the 'equity in a subsidiary not attributable, directly or indirectly, to a parent.' The NCI in a subsidiary represents the NCI's proportionate share of the carrying amount of the subsidiary's identifiable net assets (excluding goodwill) recognised in the consolidated statement of financial position.

At the parent's reporting date, the NCI in a subsidiary is measured at:

- the NCI's proportionate share of the amount of the subsidiary's identifiable net assets recognised at acquisition; plus (or minus)
- any increases (or decreases) in the group carrying amount[4] of the subsidiary's recognised net assets between the acquisition date and the reporting date.

If historical consolidated financial statements are available, NCI may be calculated as the sum of the balance in the preceding period and the changes in the current period.

[4] References in this module to the 'group carrying amount' of a subsidiary's assets and liabilities (or net assets) mean the amount at which the subsidiary's assets and liabilities (or net assets) are recognised in the consolidated financial statements.

Examples—non-controlling interest

Ex 30 **SME A acquired 90% of the share capital of SME B at 1 January 20X1 and controlled SME B from that date. In relation to SME B, assume that group financial statements are currently being prepared for the year ended 31 December 20X4 using the following information, and that there are no other changes in the carrying amount of SME B's identifiable net assets in the consolidated financial statements during 20X4:**

	CU
Carrying amount of SME B's identifiable net assets (fair value) in the consolidated statement of financial position at 1 January 20X1 (the acquisition date)	1,000
Increase in carrying amount of SME B's identifiable net assets in the consolidated statement of financial position from 1 January 20X1 to 31 December 20X3 other than those arising from comprehensive income	5,000
Comprehensive income of SME B included in the consolidated statement of comprehensive income for the year ended 31 December 20X4 (current period)	500
Carrying amount of SME B's identifiable net assets in the consolidated statement of financial position at 31 December 20X4	6,500

No transactions occurred between the two entities from 20X1 to 20X4. The ownership interest of SME A does not change.

NCI could be calculated as follows:

		CU
1.	NCI's proportionate share of the acquisition date fair values of SME B's identifiable net assets (10% × CU1,000).	100
2.	NCI's proportionate share of the change in the carrying amounts of the net assets (or equity) of the subsidiary (SME B) in the consolidated financial statements from the acquisition date to 31 December 20X3 (10% × CU5,000).	500
3.	NCI's proportionate share of the current period increase in the carrying amounts of the net assets (or equity) of the subsidiary (SME B) in the consolidated financial statements—in this example the increase relates solely to the amount of consolidated profit for 20X4 attributable to SME B (10% × CU500).	50
	Total	650

Alternatively, this can be calculated as 10% × CU6,500 (carrying amount of SME B's identifiable net assets in the consolidated statement of financial position at 31 December 20X4) = CU650.

Ex 31 **The facts are the same as in Example 28. However, in this example, Entity A acquires only 75% of the ordinary shares, to which voting rights are attached, of Entity B, but nevertheless obtains control of Entity B. Entity A pays CU4,500 for the shares.**

Non-controlling interest:

In this example, the consolidated statement of financial position is being prepared as at the date of acquisition. In order to calculate the NCI at the date of acquisition, it is only necessary to perform step 1.

Thus NCI is: 25% × Entity B's identifiable net assets at fair value of CU4,700 = CU1,175. (See footnote (a) to Example 28 for the calculation of Entity B's acquisition date identifiable net assets at fair value.)

Entity A's consolidated statement of financial position at 31 December 20X0 will be calculated as follows:

	Entity A	*Entity B*	*Consolidation adjustments*	*Consolidated*
	Carrying amount	*Carrying amount*		
	CU	*CU*	*CU*	*CU*
Assets				
Non-current assets				
Goodwill	-	-	975 [(a)]	975
Buildings and other PPE	7,000	3,000	300	10,300
Investment in Entity B	4,500	-	(4,500)	-
	11,500	3,000		11,275
Current assets				
Inventories	700	500	100	1,300
Trade receivables	300	250		550
Cash	3,000	700		3,700
	4,000	1,450		5,550
Total assets	**15,500**	**4,450**		**16,825**
Equity and liabilities				
Equity attributable to owners of parent				
Share capital	5,000	2,000	(2,000)	5,000
Retained earnings	10,200	2,300	(2,300)	10,200
	15,200	4,300		15,200
Non-controlling interest	-	-	1,175	1,175
Total equity	**15,200**	**4,300**		**16,375**
Current liabilities				
Trade payables	300	150		450
	300	150		450
Total liabilities and equity	**15,500**	**4,450**		**16,825**

In this example, the cash balance of Entity A (and consequently that of the group) is CU1,500 higher than in Example 28 because, in this example, Entity A paid CU1,500 less to acquire Entity B (CU6,000 minus CU4,500).

Consolidation involves:

- adding the statement of financial position of the parent and its subsidiary together line by line, in accordance with paragraph 9.13(a).
- applying paragraph 9.13(b), eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets acquired, liabilities and contingent liabilities assumed); and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased).
- recognising the fair value adjustments together with the goodwill that arose on acquisition of the subsidiary. (The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X0 are set out below.)
- recognising the non-controlling interest in the net assets of Entity B in accordance with paragraph 9.13(d).

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X0 are:

	CU	*CU*
Dr Asset—goodwill	975	
Dr Asset—buildings and other PPE	300	
Dr Asset—inventories	100	
Dr Equity—share capital (Entity B)	2,000	
Dr Equity—retained earnings (Entity B)	2,300	
Cr Asset—Investment in Entity B		4,500
Cr Equity—non-controlling interest		1,175

To eliminate the investment in Entity B and the acquisition date equity of Entity B and to recognise the acquiree's assets and liabilities at fair values including the goodwill recognised in the accounting for the acquisition and the non-controlling interest's share of the fair value of the subsidiary's net assets.

[(a)] Working for goodwill:

Consideration paid, cost of business combination	CU4,500
Fair value of identifiable net assets acquired, 75% of CU4,700	3,525
Goodwill	CU975

Goodwill recognised in the consolidated statement of financial position relates solely to the acquirer's proportion of the subsidiary; it does not include the non-controlling interest's share. See Section 19 *Business Combinations and Goodwill*.

Ex 32 **The facts are the same as in Example 29, but now assume that Entity A had only acquired 75% of Entity B, but nevertheless controlled Entity B. In other words, this example is a continuation of Example 31, looking at its first-year post-acquisition results in the same way that Example 29 is a continuation of Example 28 looking at its first-year post-acquisition results. At 31 December 20X1, one year after Entity A acquired Entity B, the individual statements of financial position and statements of comprehensive income of Entities A and B are:**

Statements of financial position at 31 December 20X1:

	Entity A *Carrying amount CU*	**Entity B** *Carrying amount CU*
Assets		
Non-current assets		
Buildings and other PPE	6,500	2,750
Investment in Entity B	4,500	-
	11,000	2,750
Current assets		
Inventories	800	550
Trade receivables	380	300
Cash	4,170	1,420
	5,350	2,270
Total assets	**16,350**	**5,020**
Equity and liabilities		
Equity		
Share capital	5,000	2,000
Retained earnings	11,000	2,850
	16,000	4,850
Current liabilities		
Trade payables	350	170
	350	170
Total liabilities and equity	**16,350**	**5,020**

Statements of comprehensive income for the year ended 31 December 20X1:

	Entity A *CU*	**Entity B** *CU*
Revenue	3,000	1,900
Cost of sales	(1,800)	(1,000)
Gross profit	**1,200**	**900**
Administrative expenses	(400)	(350)
Profit for the year	**800**	**550**

Note: Management's best estimate of the useful life of the goodwill is ten years. Entity A uses the straight-line amortisation method for goodwill. The fair value adjustment to buildings and other PPE is in respect of a building; all buildings have an estimated remaining useful life of 20 years from 31 December 20X0 and estimated residual values of zero. Entity A uses the straight-line method for depreciation of PPE. All of the inventory held by Entity B at 31 December 20X0 was sold to a third party during 20X1.

The NCI's proportion of Entity B is 25% and there was no change in their ownership interest since the acquisition of Entity A.

At 31 December 20X1 the NCI in the consolidated statement of financial position would be calculated as:

NCI at date of acquisition (31 December 20X0) (see Example 31)	CU1,175
NCI's share of profit for the year ended 31 December 20X1, being 25% of CU435 (being CU550 profit of B per B's financial statements minus CU100 group inventory fair value adjustment minus CU15 group depreciation on building fair value adjustment)	109
As at 31 December 20X1	CU1,284

In calculating the NCI's share of profit for the year ended 31 December 20X1, no deduction is made for goodwill amortisation because, as explained above, the goodwill arising on consolidation relates solely to the acquirer's proportion of the subsidiary and does not include the non-controlling interest's share.

As an alternative to the above three-step approach, at 31 December 20X1 the NCI in the consolidated statement of financial position is calculated as 25% (the NCI's proportion) of CU5,135, which is CU1,284. CU5,135 is Entity B's net assets at 31 December 20X1, as shown in Entity B's statement of financial position plus the fair value adjustment to those assets as made in preparing the group statement of financial position (CU285, being the fair value adjustment in respect of Entity B's building, after one year's depreciation).

Entity A's consolidated statement of comprehensive income for the year ended 31 December 20X1 will be computed as follows:

	Entity A	**Entity B**	**Consolidation adjustments**		**Consolidated**
	CU	*CU*	*CU*		*CU*
Revenue	3,000	1,900			4,900
Cost of sales	(1,800)	(1,000)	(100)	(a)	(2,900)
Gross profit	**1,200**	**900**			**2,000**
Administrative expenses	(400)	(350)	(113)	(b)	(863)
Profit for the year	**800**	**550**			**1,137**
Profit attributable to:					
Owners of the parent					1,028
Non-controlling interest					109
					1,137

Consolidation involves:

- adding the statement of comprehensive income of the parent and its subsidiary together line by line, in accordance with paragraph 9.13(a).
- recognising the fair value adjustments and/or amortisation thereof together with amortisation of the goodwill asset that arose on acquisition of the subsidiary (see the consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X1).

Entity A's consolidated statement of financial position at 31 December 20X1 will be computed as follows:

	Entity A	Entity B	Consolidation adjustments		Consolidated
	Carrying amount	*Carrying amount*			
	CU	*CU*	*CU*		*CU*
Assets					
Non-current assets					
Goodwill	-	-	877	(c)	877
Buildings and other PPE	6,500	2,750	285	(d)	9,535
Investment in Entity B	4,500	-			-
	11,000	2,750			10,412
Current assets					
Inventories	800	550			1,350
Trade receivables	380	300			680
Cash	4,170	1,420			5,590
	5,350	2,270			7,620
Total assets	**16,350**	**5,020**			**18,032**
Equity and liabilities					
Equity attributable to owners of parent					
Share capital	5,000	2,000	(2,000)		5,000
Retained earnings	11,000	2,850	(2,622)	(e)	11,228
	16,000	4,850			16,228
Non-controlling interest	-	-	1,284		1,284
	16,000	4,850			17,512
Current liabilities					
Trade payables	350	170			520
	350	170			520
Total liabilities and equity	**16,350**	**5,020**			**18,032**

Consolidation involves:

- Adding the statement of financial position of the parent and its subsidiary together line by line, in accordance with paragraph 9.13(a).
- In accordance with paragraph 9.13(b), eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets acquired, and liabilities and contingent liabilities assumed) and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased).
- recognising the fair value adjustments together with the goodwill that arose on acquisition of the subsidiary as adjusted to reflect the first-year post-acquisition—see the consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X1, and the related workings, set out below; and
- recognising the non-controlling interest in the net assets of Entity B, in accordance with paragraph 9.13(d)—see the consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X0.

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X1 are:

1. Repeat of acquisition date consolidation adjustment:

	CU	CU
Dr Asset—goodwill	975	
Dr Asset—buildings and other PPE	300	
Dr Asset—inventories	100	
Dr Equity—share capital (Entity B)	2,000	
Dr Equity—retained earnings (Entity B)	2,300	
Cr Asset—Investment in Entity B		4,500
Cr Equity—non-controlling interest		1,175

To eliminate the investment in Entity B and the acquisition date equity of Entity B and to recognise the acquiree's assets and liabilities at fair values including the goodwill recognised in the accounting for the acquisition and the non-controlling interest's share of the fair value of the subsidiary's net assets.

2. Recognition of amortisation of goodwill and fair value adjustment in respect of Entity B's building:

	CU	CU
Dr Equity—retained earnings (Group): profit or loss 20X1—administrative expenses*	113	
Cr Asset—goodwill		98[(c)]
Cr Asset—buildings and other PPE		15[(d)]

To recognise the amortisation of goodwill and the additional depreciation required in respect of the fair value adjustment to the carrying amount of the subsidiary's building in the consolidated financial statements for the year ended 31 December 20X1.

* Although this consolidation adjustment is to retained earnings in the statement of financial position, the adjustment is via the consolidated statement of comprehensive income.

3. Elimination of inventory fair value adjustment following the sale of all the inventory during the year:

	CU	CU
Dr Equity—retained earnings (Group): profit or loss 20X1—cost of sales*	100	
Cr Asset—inventories		100

To eliminate the fair value adjustment to inventory following the sale, during the year ended 31 December 20X1, of all the inventory as at 31 December 20X0.

* Although this consolidation adjustment is to retained earnings in the statement of financial position, the adjustment is via the consolidated statement of comprehensive income.

4. Recognise the NCI's share of Entity B's profit for the year:

	CU	*CU*
Dr Equity—retained earnings (Group)	109	
Cr Equity—non-controlling interest		109

To recognise the NCI's share of Entity B's profit for the year ended 31 December 20X1 as included in the consolidated statement of comprehensive income.

(a) Cost of sales adjustment:

CU100 = fair value adjustment in respect of inventories at 31 December 20X0.

(b) Administrative expenses adjustment:

CU113 = Amortisation of goodwill CU98(c) + additional depreciation on building CU15.(d)

For simplicity, it is assumed that all the goodwill amortisation and the additional buildings depreciation is adjusted against administrative expenses.

(c) Working for goodwill:

Goodwill at the acquisition date, CU975, minus accumulated amortisation, which this year is amortisation for one year, CU98 (CU975 ÷ 10 years) = CU877.

(d) Working for building consolidation adjustment:

The fair value adjustment at 31 December 20X0 in respect of Entity B's building was CU300, that is, the carrying amount in Entity B's financial statements at 31 December 20X0 was CU300 lower than was recognised in the group's consolidated statement of financial position. The building is being depreciated over 20 years from 31 December 20X0. Thus, at 31 December 20X1 the adjustment required on consolidation to the statement of financial position will be CU285, being CU300 × 19/20 years' estimated useful life remaining. The additional depreciation recognised in the consolidated statement of comprehensive income is CU15 (being CU300 x 1/20).

(e) Reserves adjustment:

CU2,300 adjustment at the acquisition date (see Example 31) plus CU98(c) amortisation of goodwill plus CU15(d) additional depreciation on building plus CU100(a) fair value adjustment in respect of inventories plus CU109 NCI's share of Entity B's profit for the year (as included in the consolidated statement of comprehensive income) = CU2,622.

9.14 The proportions of profit or loss and changes in equity allocated to the owners of the parent and to the non-controlling interest are determined on the basis of existing ownership interests and do not reflect the possible exercise or conversion of options or convertible instruments.

Examples

Ex 33 **Entities A and B (which are unrelated) own 90% and 10% respectively of the ordinary shares, which carry voting rights at a general meeting of shareholders, of Entity C. Entity A sells an option to Entity D to buy one-third of its interest in Entity C. The option is exercisable at any time, and if exercised it would give Entity D 30% of the ownership interest and voting rights in Entity C.**

The existence of the option would be considered in the determination of control because it is currently exercisable. In this example, the effect of the exercise of the option would be to reduce Entity A's ownership interest from 90% to 60% of Entity C. In the absence of evidence to the contrary, Entity A controls Entity C because it controls 60% (more than half) of the voting power in Entity C (direct ownership of 90% minus Entity D's currently exercisable option over 30%).

The proportions of profit or loss and changes in equity allocated to the parent and NCI are determined on the basis of *existing* ownership interests (90% for Entity A and 10% for Entity B). Possible exercise or conversion of the option is not reflected in the calculation of the NCI in the profit and net assets of Entity C.

It is important to understand the difference between the determination of control and the attribution of profits. Control is determined based on factors outlined in paragraphs 9.5 and 9.6. One indicator of control is voting rights attached to an entity's share of ownership interests. However, control is the power to govern the financial and operating policies of an entity, and having an option, which is currently exercisable, to acquire further ownership interests is therefore taken into account when determining control (paragraph 9.6). As discussed above, the attribution of profits and the calculation of the NCI in the net assets is based solely on existing ownership interests and not on potential ownership interests. A parent is generally only entitled to the subsidiary's income (or exposed to its losses) to the extent of its ownership interest. For example, a parent receives dividends based on its present ownership interest in the subsidiary.

Ex 34 **Entity A owns 40% of the ordinary shares, which carry voting rights at a general meeting of shareholders, of Entity B. Entity A also owns an option which, if exercised, would give Entity A a further 20% ownership interest in Entity B. The option is currently exercisable.**

In the absence of evidence to the contrary, Entity A controls Entity B because it controls 60% (more than half) of the voting power in Entity B (direct ownership of 40% and a currently exercisable option to acquire a further 20%). Consequently, Entity B is a subsidiary of Entity A and must be consolidated.

However, the attribution, between the parent and the NCI, of profit or loss, or any increases (or decreases) in the carrying amounts of the subsidiary's recognised identifiable net assets between the acquisition date and the reporting date in the consolidated financial statements, is based on the share of ownership interests that is actually owned (the option is ignored). Consequently, Entity A is allocated 40% of Entity B with the NCI allocated 60%.

Intragroup balances and transactions

9.15 Intragroup balances and transactions, including income, expenses and dividends, are eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as **inventory** and **property, plant and equipment**, are eliminated in full. Intragroup losses may indicate an **impairment** that requires **recognition** in the consolidated financial statements (see Section 27 *Impairment of Assets*). Section 29 *Income Tax* applies to **temporary differences** that arise from the elimination of profits and losses resulting from intragroup transactions.

Notes

Intragroup transactions that entities may undertake include: trading; declaring or paying dividends; and borrowing and lending money. Entities are required to account for such transactions in their individual financial statements in the same way as if they were transactions between independent entities—in other words, as if the transacting entities were not part of the same group.

For example, a parent sells inventory to its subsidiary. The parent records the sale of inventory and derecognises inventory. The subsidiary records a purchase of inventory and payment in cash or a trade payable.

If the individual financial statements of entities are simply added together without any adjustment, the consolidated financial statements would include not only the results of the group from transactions with external parties, but also the results of transactions within the group. In the example above, if the individual financial statements are simply added together the sale of the inventory would be recorded, but if the subsidiary had not sold the inventory by the year-end, the inventory would simply have been moved from one part of the group to another. Consolidated financial statements aim to present the results, cash flows and financial position of the group as if it were a single entity. Consequently, the effects of transactions within the group must be adjusted (eliminated) in the preparation of the consolidated financial statements. In this way the consolidated financial statements will only show transactions with parties outside the group.

Examples—inventory

Ex 35 **Entity A owns all of the share capital and controls Entity B. On 30 December 20X1 Entity A acquired inventory from Entity B for CU1,000. The cost to Entity B of the inventory is CU800. Consequently, the following journal entries were made in the entities' individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):**[(5)]

	Individual entity accounting records		Hypothetical group accounting records	
	CU	*CU*	*CU*	*CU*
Entity B				
Dr Asset—inventory	800		800	
Cr Asset—cash		800		800
To recognise the purchase of inventory.				
Dr Asset—cash	1,000			
Cr Income—revenue		1,000		
Dr Expense—cost of sales	800			
Cr Asset—inventory		800		
To recognise the sale of inventory.				
Entity A				
Dr Asset—inventory	1,000			
Cr Asset—cash		1,000		
To recognise the purchase of inventory for cash from Entity B.				

At 31 December (the end of the group's annual reporting period), none of the inventory purchased from Entity B had been sold by Entity A to parties outside the group.

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X1 are:

	CU	*CU*
Dr Income—revenue	1,000	
Cr Expense—cost of sales		800
Cr Asset—inventory		200
To eliminate the effects of the intragroup transaction.		

(5) From the perspective of the group there is no sale of inventory. Consequently, if a general ledger were maintained for the group (rather than separate general ledgers for the parent and the subsidiary), the sale of inventory by Entity B to Entity A would not result in any entry being recorded in the group's general ledger.

The adjustment eliminates the effect of the intragroup sale of inventory. From the group's perspective, because no external party was involved in the transaction, no sale is recognised in the consolidated financial statements.

If Entity A owned 80% of the share capital of Entity B (instead of 100%), the NCI's share of Entity B's profits for the year would exclude the profit on sale of the inventory to Entity A. In other words, NCI would be CU40 lower because of the intragroup unrealised profit in inventory than if Entity B had sold the inventory to a party outside the group. Calculation: unrealised profit CU200 (CU1,000 minus CU800) × 20% (interest in Entity B not held by Entity A) = CU40. This is consistent with presenting NCI within equity.

Assuming that, in the situation described above (where Entity A owns 80% of the share capital of Entity B), Entity A sold inventory to Entity B, there would be no adjustment to the allocation to the NCI, because the profit to be eliminated when preparing the consolidated financial statements would be made by Entity A, not Entity B, and the NCI of Entity B is not entitled to share in profits of Entity A.

Ex 36 **The facts are the same as in Example 35. However, in this example income tax is not ignored. Assume a tax rate of 20% is applicable to both Entity A and Entity B. The following journal entries are processed in the entities' individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):**

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
Entity B				
Dr Asset—inventory	800		800	
Cr Asset—cash		800		800
To recognise the purchase of inventory.				
Dr Asset—cash	1,000			
Cr Income—revenue		1,000		
Dr Expense—cost of sales	800			
Cr Asset—inventory		800		
To recognise the sale of inventory.				
Entity A				
Dr Asset—inventory	1,000			
Cr Asset—cash		1,000		
To recognise the purchase of inventory for cash from Entity B.				

At the year-end, 31 December 20X1, the following entries in respect of tax would be made:

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
	Entity B			
Dr Expense—income tax—current tax	40		40	
Cr Income—income tax—deferred tax				40
Cr Liability—current tax		40		40
Dr Asset—deferred tax			40	
To recognise the tax liability arising on the sale of inventory.				

The consolidation adjustments required for preparing the consolidated financial statements are:

	CU	*CU*
Dr Income—revenue	1,000	
Cr Expense—cost of sales		800
Cr Asset—inventory		200
Dr Asset—deferred tax	40	
Cr Income—income tax—deferred tax		40
To eliminate the effects of the intragroup transaction.		

On consolidation, a tax-effect adjustment is needed, because the first part of the adjustment decreases the carrying amount of inventory from CU1,000 (in the individual records of Entity A) to CU800 in the consolidated financial statements (a reduction of CU200) without a corresponding decrease in the tax base of the inventory (assuming the tax authorities do not make a corresponding adjustment for the purpose of determining taxable income). The CU200 difference is a deductible temporary difference (see Section 29 *Income Tax*) that gives rise to a deferred tax asset of CU40 (20% × CU200) and a corresponding decrease in income tax expense. When the inventory is sold by the group to a third party, this temporary difference reverses and the respective tax expense is recognised.

Ex 37 **Entity A owns all of the share capital and controls Entity B.**

At 1 January 20X1 Entity A acquired inventory from Entity B for CU1,000. The inventory had previously cost Entity B CU800.

On 2 February 20X1 Entity A sells all of the inventory to an external party for CU1,500.

Assume a tax rate of 20% is applicable for both Entity A and Entity B.

On the purchase of the inventory by Entity B and on 1 January 20X1 the following entries were processed in the entities' individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
Entity B				
Dr Asset—inventory	800		800	
Cr Asset—cash		800		800
To recognise the purchase of inventory.				
Dr Asset—cash	1,000			
Cr Income—revenue		1,000		
Dr Expense—cost of sales	800			
Cr Asset—inventory		800		
To recognise the sale of inventory.				
Entity A				
Dr Asset—inventory	1,000			
Cr Asset—cash		1,000		
To recognise the purchase *of inventory for cash from Entity B.*				

On 2 February 20X1 the following entries were processed in Entity A's individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
Entity A				
Dr Asset—cash	1,500		1,500	
Cr Income—revenue		1,500		1,500
Dr Expense—cost of sales	1,000		800	
Cr Asset—inventory		1,000		800
To recognise the sale of inventory.				

At the year-end on 31 December 20X1, the following entries were processed in respect of tax in the entities' individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		Hypothetical group accounting records	
	CU	*CU*	*CU*	*CU*
Entity B				
Dr Expense—income tax—current tax	40		40	
Cr Liability—current tax		40		40
To recognise the obligation to pay income tax on the sale of inventory.				
Entity A				
Dr Expense—income tax—current tax	100		100	
Cr Liability—current tax		100		100
To recognise the obligation to pay income tax on the sale of inventory.				

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X1 are:

	CU	*CU*
Dr Income—revenue	1,000	
Cr Expense—cost of sales		1,000
Elimination of the effects of the intragroup transaction.		

No consolidation adjustments for tax and inventory are necessary. Entity A records a profit of CU400 (CU1,500 revenue from the sale of goods minus CU1,000 cost of sales minus CU100 income tax expense). Entity B records a profit of CU160 (CU1,000 revenue from the sale of goods minus CU800 cost of sales minus CU40 income tax expense). The total profit recorded by the group is CU560 (CU1,500 selling price to external parties minus CU800 cost to the group minus CU140 income tax expense). The sum of the profit recognised by Entities A and B in their individual financial statements equals the profit recognised by the group in its consolidated financial statements and there is no net effect of the consolidation adjustments on profit.

If Entity A controls Entity B but owns less than 100% of the share capital of Entity B, there would be no difference to the consolidation adjustments presented above. There is no effect on profit or loss. Because the inventory was sold to a party outside the group during the year, the NCI's proportion of Entity B's profit after tax includes CU160 (CU200 minus CU40) with respect to this transaction.

Ex 38 **Entity A owns all of the share capital and controls Entity B.**

On 1 November 20X1 Entity A acquired inventory from Entity B for CU1,000. The inventory had previously cost Entity B CU800. By the end of the period, Entity A had sold half of the inventory to an external party for CU750.

Assume a tax rate of 20% is applicable to both Entity A and Entity B.

In 20X1 the following entries are processed in the entities' individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
	Entity B			
Dr Asset—inventory	800		800	
Cr Asset—cash		800		800
To recognise the purchase of inventory.				
Dr Asset—cash	1,000			
Cr Income—revenue		1,000		
Dr Expense—cost of sales	800			
Cr Asset—inventory		800		
To recognise the sale of inventory to Entity A.				
	Entity A			
Dr Asset—inventory	1,000			
Cr Asset—cash		1,000		
To recognise the purchase of inventory for cash from Entity B.				

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
Dr Asset—cash	750		750	
Cr Income—revenue		750		750
Dr Expense—cost of sales	500		400	
Cr Asset—inventory		500		400
To recognise the sale of inventory.				

At the year-end, on 31 December 20X1, the following entries were processed in respect of tax in the entities' individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
Entity B				
Dr Expense—income tax—current tax	40		40	
Cr Liability—current tax		40		40
Dr Asset—deferred tax			20	
Cr Income—income tax—deferred tax				20
To recognise the obligation to pay income tax on the sale of inventory.				
Entity A				
Dr Expense—income tax—current tax	50		50	
Cr Liability—current tax		50		50
To recognise the obligation to pay income tax on the sale of inventory.				

The consolidation adjustments required for preparing the consolidated financial statements at the end of the period are:

	CU	*CU*
Dr Income—revenue	1,000	
Cr Expense—cost of sales		900
Cr Asset—inventory		100
Dr Asset—deferred tax	20	
Cr Income—income tax—deferred tax		20
To eliminate the effects of the intragroup transaction.		

The income (revenue from the sale of goods) recognised by Entity A and Entity B is CU1,750 (Entity A's income of CU750 and Entity B's income of CU1,000). However, the group's consolidated income from inventory sold to external parties is only CU750.

The total cost of sales recorded individually by Entity A and Entity B is CU1,300 (Entity A's cost of sales of CU500 and Entity B's cost of sales of CU800). However, the group's cost of sales is only CU400 (50% of CU800—the cost of the inventory the group sold to the external party).

The CU100 adjustment to inventory reflects that portion of the total profit on sale of the transferred inventory that remains in the inventory on hand at the end of the period. Because 50% of the transferred inventory is still on hand at the end of the period, 50% of the total profit on the intragroup transfer of inventory (50% × CU200) is eliminated at the end of the period.

Although there is a difference of CU100 between the carrying amount of inventory in the individual records of Entity A (CU500) and in the consolidated financial statements (CU400) the tax base of the inventory in both the consolidated and separate entity financial statements is CU500 (assuming the tax authorities do not make a corresponding adjustment for the purpose of determining taxable income). Consequently, there is a CU100 deductible temporary difference that gives rise to a deferred tax asset of CU20 (20% × CU100) in the consolidated statement of financial position and a corresponding effect in equity (the income tax expense component of profit or loss for the year ended 31 December 20X1).

Ex 39 **Entity A owns all of the share capital and controls Entity B.**

The facts are the same as in Example 38. Consequently, on the first day of its next accounting period, 1 January 20X2, Entity A has inventory with a carrying amount of CU500, which it acquired from Entity B in 20X1. The inventory cost Entity B CU400.

Assume a tax rate of 20% is applicable to both Entity A and Entity B and that the inventory acquired from Entity B is still on hand at 31 December 20X2.

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X2 assuming the inventory has not been sold by Entity A are:

	CU	*CU*
Dr Equity—retained earnings	100	
Cr Asset—inventory		100
Dr Asset—deferred tax	20	
Cr Equity—retained earnings		20

To eliminate the effects of the intragroup transaction that occurred in 20X1.

Inventories acquired from Entity B in 20X1 remain in Entity A's individual statement of financial position at CU500, which includes group profit of CU100 (because its original cost to Entity B was CU400). Because the transfer occurred in the prior period, profits are recognised in Entity B's retained earnings. Consolidation adjustments must reduce inventories by the amount of profit and reduce consolidated retained earnings by the same amount (the profit remains unrealised to the group because the inventory still has not been sold to a party outside the group).

The CU100 consolidation adjustment therefore ensures that the carrying amount in the consolidated financial statements is CU400 (rather than the CU500 that is the carrying amount in the individual records of Entity A). However, there is no corresponding decrease in the tax base of the inventory. Consequently, a deferred tax asset of CU20 is recognised in the consolidated statement of financial position with a corresponding effect on equity (retained earnings); again, the adjustment is to retained earnings because the transfer occurred in the previous year.

Ex 40 **Entity A owns all of the share capital and controls Entity B.**

The facts are the same as in Examples 38 and 39. During 20X3 Entity A sells the remainder of the inventory that it had acquired from Entity B in 20X1; Entity A sells it for CU750 to a third party.

Assume a tax rate of 20% is applicable to both Entity A and Entity B.

In 20X3 the following entries are processed in Entity A's individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
Dr Asset—cash	750		750	
Cr Income—revenue		750		750
Dr Expense—cost of sales	500		400	
Cr Asset—inventory		500		400
To recognise the sale of inventory.				

At the year-end, on 31 December 20X3, the following entries were processed in respect of tax in Entity A's individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
	Entity A			
Dr Expense—income tax—current tax	50		50	
Cr Liability—current tax		50		50
Dr Expense—income tax—deferred tax			20	
Cr Asset—deferred tax				20
To recognise the obligation to pay income tax on the sale of inventory.				

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X3 are:

	CU	*CU*
Dr Equity—retained earnings*	100	
Cr Expense—cost of sales		100
Dr Expense—income tax—deferred tax	20	
Cr Equity—retained earnings*		20
To eliminate the effects of the intragroup transaction.		

* When comparing the group and individual entity accounting entries above, it would appear that CU100 should be credited to inventory, not retained earnings. However, the journal entries 'tell the story' as it occurs whereas the consolidation adjustments set out to adjust the individual entity financial statements; because the CU100 was eliminated from the consolidated financial statements in 20X1 (see Example 38) the adjustment is to retained earnings. The same applies to the CU20 deferred tax adjustment; when adjusting the individual entity financial statements, the adjustment is to retained earnings because it was credited to the consolidated income statement in 20X1.

The income (revenue from the sale of goods) recognised by Entity A is CU750. Because this is the same as the group's consolidated income from inventory sold to external parties, no consolidation adjustment is required to income.

The group's cost of sales is CU400 (50% of CU800 cost, being the cost when the group purchased the inventory from a party external to the group; see Example 38). The cost of sales recorded individually by Entity A is CU500. Accordingly, a consolidation adjustment of CU100 is required; this ensures that the profit recognised in 20X3 is CU350. CU100 of this was already recognised in Entity B's financial statements in 20X1 and thus is in retained earnings in Entity B's individual financial statements. It is therefore necessary to debit retained earnings so that group retained earnings at 31 December 20X3 are not overstated.

Tax at 20% of the group profit of CU350 is CU70. Entity A has recognised CU50 of this in its individual entity financial statements in 20X3. The other CU20 is recognised as a deferred tax asset in the opening consolidated statement of financial position (as a result of the earlier year's consolidation adjustment). Hence the final consolidation adjustment increases the tax charge in the income statement for the year ended 31 December 20X3 by CU20 and credits retained earnings; the credit to retained earnings is replicating the adjustment in 20X1 which had set up the deferred tax asset.

Examples—property, plant and equipment

Ex 41 **Entity A owns all the share capital and controls Entity B. On 31 December 20X2 Entity A acquires a plot of land from Entity B on which the group plans to construct its new headquarters building. The carrying amount of the land in Entity B's individual accounting records was CU1,000 and the selling price is CU1,100.**

The following entries were processed in the entities' individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		Hypothetical group accounting records	
	CU	*CU*	*CU*	*CU*
Entity B				
Dr Asset—property, plant and equipment	1,000		1,000	
Cr Asset—cash		1,000		1,000
To recognise the purchase of land for cash.				
Dr Asset—cash	1,100			
Cr Asset—property, plant and equipment		1,000		
Cr Income—profit on sale of property, plant and equipment		100		
To recognise the sale of land for cash.				
Entity A				
Dr Asset—property, plant and equipment	1,100			
Cr Asset—cash		1,100		
To recognise the purchase of land for cash from Entity B.				

The consolidation adjustments required for preparing the group's consolidated financial statements for the year ended 31 December 20X2 are:

	CU	*CU*
Dr Income—profit on sale of property, plant and equipment	100	
Cr Asset—property, plant and equipment		100
Elimination of the effects of the intragroup sale of land.		

The consolidation adjustments above 'reduce' the carrying amount of the land from CU1,100 in the individual records of Entity A to CU1,000 in the consolidated financial statements (to its cost to the group). In other words, the consolidation adjustment eliminates the effect of the intragroup transaction (a CU100 'increase' in the carrying amount of land and the profit (CU100) recognised in Entity B's individual financial statements for the disposal of land).

Ex 42 **Entity A owns all the share capital and controls Entity B. On 1 January 20X2, Entity A acquired a building from Entity B, for CU600, that the group plans to use as its new head office. Entity B had purchased the building from a third party on 1 January 20X1 for CU525. At the time the building was assessed to have a useful life of 21 years and a residual value of nil. On 1 January 20X2 the carrying amount of the building was CU500 in Entity B's individual accounting records. The estimated remaining useful life of the building measured from 1 January 20X2 is 20 years and the residual value of the building is still nil. The method of depreciation is straight-line.**

The following entries were processed in the entities' individual accounting records (and next to these entries are shown the entries that would have been made in the group's accounting records if the group maintained a general ledger):

	Individual entity accounting records		**Hypothetical group accounting records**	
	CU	*CU*	*CU*	*CU*
	Entity B			
1 January 20X1				
Dr Asset—property, plant and equipment	525		525	
Cr Asset—cash		525		525
To recognise the purchase of the building for cash.				
31 December 20X1				
Dr Expense—depreciation	25[(a)]		25	
Cr Asset—property, plant and equipment		25		25
To recognise the consumption of the building's service potential in 20X1.				

	Individual entity accounting records		Hypothetical group accounting records	
	CU	*CU*	*CU*	*CU*
1 January 20X2				
Dr Asset—cash	600			
Cr Asset—property, plant and equipment		500		
Cr Income—profit on sale of property, plant and equipment		100		
To recognise the sale of the building for cash.				
	Entity A			
1 January 20X2				
Dr Asset—property, plant and equipment	600			
Cr Asset—cash		600		
To recognise the purchase of a building for cash from Entity B.				
31 December 20X2				
Dr Expense—depreciation	30[(b)]		25	
Cr Asset—property, plant and equipment		30		25
To recognise the consumption of the building's service potential in 20X2.				

The consolidation adjustments required for preparing the group's consolidated financial statements for the year ended 31 December 20X2 are:

	CU	*CU*
Dr Income—profit on sale of property, plant and equipment	100	
Cr Asset—property, plant and equipment		100
Dr Asset—property plant and equipment	5[(a)]	
Cr Expense—depreciation		5
To eliminate the effects of the intragroup transaction.		

The differences between the carrying amount, in the consolidated financial statements and the carrying amount in the individual entity financial statements of Entity A, of the building in 20X2 are summarised as follows:

	Consolidated financial statements	Individual entities' financial statements		Difference
		Entity A	Entity B	
	CU	*CU*	*CU*	*CU*
31 December 20X1	**500**	**–**	**500**	**–**
1 January 20X2 purchase/sale	–	600	(500)	100
Depreciation for 20X2	(25)	(30)	–	(5)
31 December 20X2	**475**	**570**	**–**	**95**

On 1 January 20X2 the group carrying amount of the building is CU100 less than in Entity A's individual records. When using the financial information of the individual entities (Entities A and B) as the starting point from which to prepare the group's consolidated financial statements, the consolidation adjustments above eliminate the effects of the intragroup transaction.

(a) CU5 of the depreciation recognised by Entity A must be eliminated when preparing the consolidated financial statements because Entity A recognises in its individual records CU30 depreciation for 20X2,[c] whereas the group's depreciation expense for the same period is CU25.[b]

(b) The depreciation expense of Entity B and the group is CU25 for each year (cost to Entity B and to the group of CU525 divided by 21 years' estimated useful life).

(c) Entity A recognises in its individual records CU30 depreciation for 20X2 (expense based upon a depreciable amount of CU600 divided by 20 years' estimated remaining useful life).

Example—intragroup rent

Ex 43 **Entity A owns all of the share capital and controls Entity B. During 20X2 (the current financial period) Entity A rented office space to Entity B in return for which Entity B paid CU100 to Entity A. The journal entries for rent processed by Entity A and Entity B in their individual accounting records for 20X2 are:**

Entity A	*CU*	*CU*
Dr Asset—cash	100	
Cr Income—operating lease rent		100
To recognise rental income received in cash.		
Entity B		
Dr Expense—operating lease rent	100	
Cr Asset—cash		100
To recognise rent paid in cash.		

This is all internal to the group and does not involve a third party. Accordingly the consolidation adjustments required for preparing the group's consolidated financial statements are:

	CU	CU
Dr Income—operating lease rent	100	
Cr Expense—operating lease rent		100
To eliminate the effects of the intragroup transaction.		

In the absence of the above consolidation adjustment, there would be no net impact on the profit of the group. However, the amounts reported as rent income and rent expense would both be overstated.

Examples—intragroup dividends

Ex 44 **Entity A owns all the share capital and controls Entity B. On 31 December 20X2 Entity B declared and paid a dividend of CU50 from profits earned after the date on which it was acquired by Entity A. The journal entries processed in the individual accounting records by Entities A and B relating to this transaction are:**

Entity A	CU	CU
Dr Asset—cash	50	
Cr Income—dividends		50
To recognise dividends received in cash.		

Entity B	CU	CU
Dr Equity—retained earnings: dividends	50	
Cr Asset—cash		50
To recognise dividends paid in cash.		

From the group's perspective there are no dividends declared and there is no dividend income. Consequently, the consolidation adjustments required to prepare the group's consolidated financial statements for the year ended 31 December 20X2 are:

	CU	CU
Dr Income—dividends	50	
Cr Equity—retained earnings		50
To eliminate the effects of the intragroup dividend transaction.		

Note: Example 46 illustrates intragroup dividends where the subsidiary is not wholly owned.

Ex 45 **The facts are the same as in Example 44. However, in this example, at 31 December 20X2 the dividend is unpaid. The journal entries processed by Entities A and B in their individual accounting records relating to this transaction are:**

Entity A	*CU*	*CU*
Dr Asset—dividend receivable	50	
Cr Income—dividends		50
To recognise the dividend income and the receivable.		

Entity B	*CU*	*CU*
Dr Equity—retained earnings:		
dividend appropriation	50	
Cr Liability—dividend payable		50
To recognise the dividends declared and liability to pay dividends.		

From the group's perspective, there is no dividend transaction. Consequently, the consolidation adjustments required for preparing the group's consolidated financial statements for the year ended 31 December 20X2 are:

	CU	*CU*
Dr Income—dividends	50	
Cr Asset—dividend receivable		50
Dr Liability—dividend payable	50	
Cr Equity—retained earnings:		50
dividend appropriation		
To eliminate the effects of the intragroup dividend transaction.		

Ex 46 **Entity A owns 80% of the share capital and controls Entity B. In 20X2 Entity B declared a dividend of CU1,000 from profits earned after the acquisition date. The journal entries processed by Entities A and B in their individual accounting records relating to this transaction are:**

Entity A	*CU*	*CU*
Dr Asset—dividend receivable	800	
Cr Income—dividends		800
To recognise dividend income and the receivable.		

Entity B	*CU*	*CU*
Dr Equity—retained earnings:		
dividend appropriation	1,000	
Cr Liability—dividend payable		1,000
To recognise dividends declared and liability to pay dividends.		

A declaration of dividends by a partly owned subsidiary reduces the group carrying amount of the subsidiary's net assets and consequently reduces the NCI's attributable share in the subsidiary's equity. The consolidation adjustments required for preparing the group's consolidated financial statements for the year ended 31 December 20X2 are:

	CU	CU
Dr Income—dividends	800	
Cr Asset—dividend receivable		800
Dr Liability—dividend payable	800	
Dr Equity—NCI	200	
Cr Equity—retained earnings: dividend appropriation		1,000

To eliminate the intragroup dividend transaction.

Note: the dividend payable by the subsidiary to the parent is internal to the group and consequently it is eliminated on consolidation. The group has an obligation to pay the NCI its portion of the dividends declared by the subsidiary (the group's cash will decrease by CU200 when the dividend is paid to the NCI).

In other words, in this example, when the subsidiary declared the dividend, the NCI's attributable share of post-acquisition retained earnings is reduced by CU200 and a liability of CU200 to pay dividends to NCI is recognised in the consolidated statement of financial position.

Example—a subsidiary's functional currency is different from the group's reporting currency

Ex 47 **On 1 January 20X1 Entity A acquired 75% of the share capital, and control, of Entity B for FCU7,500 (FCU is the functional currency of Entity B).**
On 1 January 20X1 Entity B's net assets totalled FCU10,000. Entity A's functional currency is CU and the presentation currency of the group is CU. The exchange rate on 1 January 20X1 was CU8:FCU1. No goodwill or fair value adjustments arose.

The individual trial balances of Entities A and B at 31 December 20X1 are:

	Entity A *CU*	**Entity B** *FCU*
Equity—share capital	(100)	(1,000)
Equity—retained earnings:		
- at 1 January 20X1	(80,000)	(9,000)
- profit for 20X1	(10,000)	(5,000)
Asset—investment in Entity B	60,000 [(a)]	
Asset—property, plant and equipment (machine)	–	6,000
Asset—cash	30,100	9,000

[(a)] FCU7,500 × 8:1 = CU60,000.

Note: the existence of a subsidiary (Entity B) with a different functional currency to the group's presentation currency has little effect upon the consolidation procedures necessary to be performed. However, Entity B's trial balance must first be translated from FCU to CU (see Module 30 *Foreign Currency Translation* for additional guidance) before performing the 'normal' consolidation procedures.

Relevant exchange rates are as follows:

1 January 20X1	CU8:FCU1
31 December 20X1	CU7:FCU1
Weighted average (approximating actual) for 20X1	CU7.5:FCU1

Translating Entity B's trial balance from FCU to CU:

	Entity B *FCU*	**Exchange rate**	**Entity B** *CU*
Equity—share capital	(1,000)	8:1	(8,000)
Equity—retained earnings			
- at 1 January 20X1	(9,000)	8:1	(72,000)
- profit for 20X1	(5,000)	7.5:1	(37,500)
Asset—property, plant and equipment (machine)	6,000	7:1	42,000
Asset—cash	9,000	7:1	63,000
Other comprehensive income—translation difference			12,500 [(b)]

[(b)] This represents: (i) the difference arising on retranslation of the opening net assets of FCU10,000 from the rate at the start of the year (8:1) to the rate at the end of the year (7:1); plus (ii) retranslating the profit for the year (FCU5,000) at the actual rate for the year (as used in the consolidated statement of comprehensive income) to the closing rate (as used in the consolidated statement of financial position) = (FCU10,000 × (8 – 7)) + (FCU5,000 × (8 – 7.5)) = CU12,500 debit.

The group's consolidated statement of comprehensive income for the year ended 31 December 20X1:

	Entity A *CU*	**Entity B** *CU*	**Consolidation adjustments** *CU*	**Consolidated** ***CU***
…				
Profit for the year	**10,000**	**37,500**		**47,500**
Other comprehensive income—translation difference	-	-	(12,500) [(c)]	(12,500)
Total comprehensive income for 20X1	**10,000**	**37,500**	**(12,500)**	**35,000**

Profit for 20X1 is attributed as follows:[(f)]	
Owners of Entity A	38,125
Non-controlling interest	9,375 [(d)]
	47,500
Total comprehensive income for 20X1 is attributed as follows:[(f)]	
Owners of Entity A	28,750
Non-controlling interest	6,250 [(e)]
	35,000

[(c)] See translated trial balance above.[(b)]

[(d)] 25% (NCI's share) × CU37,500 Entity B's profit for 20X1 = CU9,375.

[(e)] 25% (NCI's share) × (CU37,500 Entity B's profit minus CU12,500 Entity B's other comprehensive income) = CU6,250.

[(f)] See the discussion on paragraph 9.21.

Module 9—Consolidated and Separate Financial Statements

The group's statement of financial position at 31 December 20X1:

	Entity A	Entity B	Consolidation adjustments		Consolidated
	CU	*CU*	*CU*		*CU*
Assets					
Non-current assets					
Asset—investment in Entity B	60,000	-	(60,000)		-
Asset—property, plant and equipment (machine)	-	42,000			42,000
	60,000	42,000			42,000
Current assets					
Asset—cash	30,100	63,000			93,100
	30,100	63,000			93,100
Total assets	**90,100**	**105,000**			**135,100**
Equity attributable to owners of parent					
Equity—share capital	100	8,000	(8,000)		100
Equity—retained earnings	90,000	109,500	(81,375)	(g)	118,125(j)
Equity—currency translation reserve	-	(12,500)	3,125	(h)	(9,375)
	90,100	105,000			108,850
Non-controlling interest	-	-	26,250	(i)	26,250
Total equity	**90,100**	**105,000**			**135,100**

(g) CU72,000 Entity B's retained earnings (retained earnings of FCU9,000 translated using the exchange rate at the beginning of the period, CU8:FCU1) before it became part of the group + CU9,375(d) NCI's share of the group measure of Entity B's retained earnings earned since it became part of the group = CU81,375.

(h) 25% share (the portion attributable to the NCI) of the CU12,500 cumulative loss on translating Entity B from FCU to CU to include it in the group's financial statements = CU3,125.

(i) 25% (NCI's share) × (CU63,000 Entity B's cash + CU42,000 Entity B's machine) = CU26,250.

(j) This is the same as CU80,000 (retained earnings of Entity A at 1 January 20X1) plus CU38,125 (profit for 20X1 attributable to the owners of Entity A taken from the consolidated statement of comprehensive income for 20X1).

Uniform reporting date

9.16 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same reporting date unless it is **impracticable** to do so. If it is impracticable to prepare the financial statements of a subsidiary as of the same reporting date as the parent, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary, adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.

Notes

The requirement set out in paragraph 9.16 is consistent with the principle that consolidated financial statements should present the group as a single economic entity. According to the Glossary, it is 'impracticable' to prepare the financial statements of a subsidiary as of the same reporting date as the parent when an entity cannot prepare them 'after making every reasonable effort to do so'. In such circumstances, the consolidated financial statements are required to be prepared using the subsidiary's most recent financial statements, as adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. (Examples of significant transactions or events include the sale of a significant item of property or a significant impairment loss for the entity's main production plant.)

Example

Ex 48 **Regulations in the separate jurisdictions in which Entity A and Entity B are domiciled specify a financial year-end of 31 December for Entity A and 30 September for Entity B. Entity B has been Entity A's wholly-owned subsidiary since 20X1.**

As required by regulations, Entity B prepares annual financial statements (its general purpose financial statements) with a 30 September year-end. However, Entity B's financial information must be consolidated with Entity A's financial information to prepare the group's annual consolidated financial statements. The consolidated financial statements have a 31 December year-end because Entity A is the parent. Consequently, when preparing the consolidated financial statements for the year ended 31 December 20X5, Entity B must prepare financial information for the year to 31 December unless it is impracticable to do so. Preparation of such financial information will be in addition to its annual financial statements, and might be in the form of an internal reporting package to Entity A. If this is not practicable, Entity B's financial statements for the year ended 30 September 20X5 will be used after adjustments have been made for the effects of significant transactions or events that occurred during the during the three months to 31 December 20X5.

Uniform accounting policies

9.17 Consolidated financial statements shall be prepared using uniform **accounting policies** for like transactions and other events and conditions in similar circumstances. If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.

Notes

Preparing consolidated financial statements using uniform accounting policies for like transactions is consistent with the principle that consolidated financial statements should present a group as a single economic entity.

Using the group accounting policies in the individual accounting records of a parent and all of its subsidiaries should simplify the consolidation process. If a parent or any subsidiary uses an accounting policy that is different from the group accounting policy, adjustments must be made when preparing the consolidated financial statements so that the consolidated financial statements are prepared on the basis of uniform accounting policies.

Example

Ex 49 **Entity A has a wholly-owned subsidiary, Entity B. Entity A uses the equity method to account for its investments in associates in its separate financial statements. Entity B uses the cost model for its associates.**

Assuming that the group's accounting policy for such investments specifies use of the equity method, when preparing the group's consolidated financial statements, Entity B's investments in associates must be measured using the equity method. This difference between Entity B's policy and that of the group will result in adjustments being made on consolidation.

Acquisition and disposal of subsidiaries

9.18 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date until the date on which the parent ceases to control the subsidiary. When a parent ceases to control a subsidiary, the difference between the proceeds from the disposal of the subsidiary and its carrying amount at the date that control is lost is recognised in profit or loss in the consolidated **statement of comprehensive income** (or the **income statement**, if presented) as the **gain** or loss on the disposal of the subsidiary. The cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in **other comprehensive income** in accordance with Section 30 *Foreign Currency Translation* is not reclassified to profit or loss on disposal of the subsidiary.

Note—disposal of a subsidiary

In the consolidated financial statements, a subsidiary's depreciable non-current assets, including goodwill, are depreciated (amortised) up to the date of disposal of the subsidiary. The carrying amount of the goodwill relating to the subsidiary, at the date that control of the subsidiary is lost, is included in the calculation of the profit or loss arising on disposal of the subsidiary; it forms part of the 'carrying amount' of the subsidiary. The cumulative exchange differences, if any, recognised in other comprehensive income in respect of the subsidiary, and reported as a separate component of equity as required by paragraph 30.13 of Section 30 *Foreign Currency Translation*, are not reclassified to profit or loss on disposal of the related subsidiary. Consequently, the cumulative exchange differences are not reflected in the calculation of the profit or loss arising on disposal of the subsidiary.

Cumulative exchange differences in other comprehensive income result from: (a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate; and (b) translating the opening net assets at a closing rate that differs from the previous closing rate (see paragraph 30.20). Although the amount of the cumulative exchange differences cannot be reclassified to profit or loss on disposal of the related subsidiary, it can be transferred from the separate component of equity, for example, from a foreign currency translation reserve, to retained earnings as a reserves transfer, assuming there is no restriction imposed by the jurisdiction in which the entity is based. For the Board's most recent deliberations on the permissibility of such transfers, see paragraph BC234.

Ex 50 **Entity A has a number of wholly-owned subsidiaries, including Entity B. On 30 March 20X1 Entity A sold all of the shares in Entity B to an independent third party for CU1,500.**

Entity A's consolidated statement of financial position and the group carrying amount of Entity B's assets and liabilities (the amount included in that consolidated statement of financial position in respect of Entity B's assets and liabilities) as at 30 March 20X1 are as follows:

	Consolidated	**Group carrying amount of Entity B's assets and liabilities**
	CU	*CU*
Assets		
Non-current assets		
Goodwill arising from the acquisition of Entity B	90	90
Buildings	1,620	670
	1,710	
Current assets		
Inventories	70	20
Trade receivables	850	450
Cash	1,550	500
	2,470	
Total assets	**4,180**	**1,730**
Equity and liabilities		
Equity		
Share capital	800	
Retained earnings	2,030	
	2,830	
Current liabilities		
Trade payables	1,350	450
	1,350	
Total liabilities and equity	**4,180**	**450**

Entity A group's consolidated statement of financial position at 31 March 20X1 after disposal of the subsidiary:

	CU	
Assets		
Non-current assets		
Buildings	950	
	950	
Current assets		
Inventories	50	
Trade receivables	400	
Cash	2,550	(a)
	3,000	
Total assets	**3,950**	
Equity and liabilities		
Equity		
Share capital	800	
Retained earnings	2,250	(b)
	3,050	
Current liabilities		
Trade payables	900	
	900	
Total liabilities and equity	**3,950**	

Workings:

When sold, the carrying amount of all assets and liabilities attributable to Entity B were eliminated from the consolidated statement of financial position.

(a) Cash before disposal of Entity B, CU1,550, minus cash of Entity B of CU500 + proceeds of CU1,500 from the sale of Entity B = cash of CU2,550.

(b) Proceeds from the sale of Entity B, CU1,500, minus net assets relating to Entity B of CU1,280 = gain on the disposal of Entity B of CU220.

Retained earnings before disposal of Entity B of CU2,030 + gain on the disposal of Entity B of CU220 = retained earnings of CU2,250.

Extract from Entity A group's consolidated statement of comprehensive income for the year ended 31 December 20X1:

	CU
Revenue	X
Cost of sales	(X)
Gross profit	**X**
Other income	X
Administrative expenses	(X)
Distribution expenses	(X)
Gain on disposal of subsidiary	220
Profit before tax	**X**
….	

Note: assume now that the consolidated retained earnings of CU2,030 immediately before the disposal of Entity B were changed to:

Retained earnings	CU1,850
Foreign currency translation reserve	CU180

and that the foreign currency translation reserve relates solely to Entity B.

The calculation of the gain on disposal of Entity B will be identical to that above, so that the gain on disposal included in the consolidated statement of comprehensive income will be CU220. In the consolidated statement of financial position as at 31 March 20X1 the foreign currency translation reserve could be transferred to retained earnings that will then result to a balance of CU2,250.

Section 9 requires the gain or loss on the disposal of a subsidiary that is included in the consolidated statement of comprehensive income to be calculated without any adjustment for the cumulative exchange difference in equity in respect of the subsidiary. This avoids the need for an SME to track which exchange differences relate to which subsidiary (as this could be difficult where an entity has several subsidiaries). However, where an SME has chosen to track this information, or, as in this example, where there is only one overseas subsidiary, the balance in respect of the subsidiary may be (but is not required to be) transferred, as a reserves transfer, out of the foreign currency translation reserve into retained earnings on disposal of the subsidiary.

9.19 If an entity ceases to be a subsidiary but the investor (former parent) continues to hold an investment in the former subsidiary, that investment shall be accounted for as a financial asset in accordance with Section 11 or Section 12 *Other Financial Instrument Issues* from the date the entity ceases to be a subsidiary, provided that it does not become an **associate** (in which case Section 14 *Investments in Associates* applies) or a **jointly controlled entity** (in which case Section 15 *Investments in Joint Ventures* applies). The carrying amount of the investment at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial **measurement** of the financial asset.

Example

Ex 51 **Entity A had a wholly-owned subsidiary, Entity B, along with a number of other wholly-owned subsidiaries. On 30 March 20X1 Entity A sold 90% of the shares in Entity B to a third party for CU1,350.**

Entity A's consolidated statement of financial position and the group carrying amount of Entity B's assets and liabilities (the amount included in that consolidated statement of financial position in respect of Entity B's assets and liabilities) as at 30 March 20X1 are as follows:

	Consolidated	Group carrying amount of Entity B's assets and liabilities
	CU	*CU*
Assets		
Non-current assets		
Goodwill arising from the acquisition of Entity B	90	90
Buildings	1,620	670
	1,710	
Current assets		
Inventories	70	20
Trade receivables	850	450
Cash	1,550	500
	2,470	
Total assets	**4,180**	**1,730**
Equity and liabilities		
Equity		
Share capital	800	
Retained earnings	2,030	
	2,830	
Current liabilities		
Trade liabilities	1,350	450
	1,350	
Total liabilities and equity	**4,180**	**450**

Entity A's consolidated statement of financial position immediately after disposal of the 90% interest in Entity B:

	CU	
Assets		
Non-current assets		
Buildings	950	
Financial asset–investment in Entity B	128	(a)
	1,078	
Current assets		
Inventories	50	
Trade receivables	400	
Cash	2,400	(b)
	2,850	
Total assets	**3,928**	
Equity and liabilities		
Equity		
Share capital	800	
Retained earnings	2,228	(c)
	3,028	
Current liabilities		
Trade liabilities	900	
	900	
Total liabilities and equity	**3,928**	

Workings:
All assets and liabilities attributable to the subsidiary, Entity B, were eliminated from the consolidated statement of financial position and replaced by a financial asset, which is initially measured at CU128 (10% of the group carrying amount of the net assets of Entity B at the date it ceased to be a subsidiary, CU1,280). This is deemed to be the cost of the financial asset.

(a) Financial asset CU128 = 10% × group carrying amount of the net assets of Entity B of CU1,280 (= CU1,730 minus CU450).

(b) Cash before disposal of 90% of the shares, CU1,550, minus cash of Entity B of CU500 + proceeds of CU1,350 from the sale of 90% of the shares = cash of CU2,400.

(c) The gain on the disposal of 90% of the shares, CU198, is calculated as the proceeds from the sale of 90% of the shares, CU1,350, minus 90% of the group carrying amount of Entity B's net assets, CU1,152.

Retained earnings before disposal of the 90% of the shares of CU2,030 + gain on the disposal of the 90% of the shares of CU198 = retained earnings of CU2,228.

Extract from Entity A's consolidated statement of comprehensive income for the year ended 31 December 20X1:

	CU
Revenue	X
Cost of sales	(X)
Gross profit	**X**
Other income	X
Administrative expenses	(X)
Distribution expenses	(X)
Gain on disposal of subsidiary	198
Profit before tax	**X**
....	

After disposal, the financial investment is accounted for as a financial asset from the date that Entity B ceases to be a subsidiary, in accordance with Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instrument Issues*.

Ex 52 **Entity A had a 60% interest in a subsidiary, Entity B, along with a number of other, wholly-owned, subsidiaries.**

On 30 March 20X1 Entity A sold half of its interest in Entity B to a third party for CU550. No goodwill was recognised in the consolidated statement of financial position at the date of the disposal of the shares, because the goodwill was fully amortised. After the disposal, the remaining interest satisfied the definition of an associate in Section 14.

Entity A's consolidated statement of financial position and the group carrying amount of Entity B's assets and liabilities (the amount included in that consolidated statement of financial position in respect of Entity B's assets and liabilities) at 30 March 20X1 are as follows:

	Consolidated	**Group carrying amount of Entity B's assets and liabilities**
	CU	*CU*
Assets		
Non-current assets		
Buildings	1,620	670
	1,620	
Current assets		
Inventories	70	20
Trade receivables	850	450
Cash	1,550	500
	2,470	
Total assets	**4,090**	**1,640**
Equity and liabilities		
Equity attributable to owners of parent		
Share capital	800	
Retained earnings	1,464	
	2,264	
Non-controlling interest	476	
Total equity	**2,740**	
Current liabilities		
Trade liabilities	1,350	450
	1,350	
Total liabilities and equity	**4,090**	**450**

Consolidated statement of financial position of Entity A after disposal of half of the previous interest in Entity B:

	CU	
Assets		
Non-current assets		
Buildings	950	
Investment in associate	357	(a)
	1,307	
Current assets		
Inventories	50	
Trade receivables	400	
Cash	1,600	(b)
	2,050	
Total assets	**3,357**	
Equity and liabilities		
Equity		
Share capital	800	
Retained earnings	1,657	(c)
	2,457	
Current liabilities		
Trade liabilities	900	
	900	
Total liabilities and equity	**3,357**	

Workings:
All assets and liabilities attributable to the subsidiary, Entity B, were eliminated from the consolidated statement of financial position.
The NCI was eliminated from the consolidated statement of financial position because Entity A no longer controls Entity B (and there is no need to recognise NCI).
A new asset was recognised in the consolidated statement of financial position of Entity A: Investment in associate.
(a) Investment in the associate of CU357 is the group carrying amount of the remaining 30% investment in Entity B. Investment in the associate of CU357 = 30% × net assets of Entity B of CU1,190.
(b) Cash before disposal of 30% interest, CU1,550, minus cash of Entity B of CU500, + proceeds of CU550 from the sale of 30% of the shares = cash of CU1,600.
(c) The gain on the disposal of 30% of the shares, CU193, is calculated as the proceeds from the sale of 30% interest, CU550, minus CU357, 30% of the net assets of Entity B of CU1,190.
Retained earnings of CU1,464 before disposal of the 30% of the shares + gain on the disposal of the 30% of the shares of CU193 = retained earnings of CU1,657.

Extract from Entity A's consolidated statement of comprehensive income for the year ended 31 December 20X1:

	CU
Revenue	X
Cost of sales	(X)
Gross profit	**X**
Other income	X
Administrative expenses	(X)
Distribution expenses	(X)
Gain on disposal of subsidiary	193
Profit before tax	**X**
....	

The investment in the associate must be accounted for in accordance with Section 14 *Investments in Associates* from the date Entity B ceased to be a subsidiary.

Non-controlling interest in subsidiaries

9.20 An entity shall present non-controlling interest in the consolidated **statement of financial position** within equity, separately from the equity of the owners of the parent, as required by paragraph 4.2(q).

Notes

When a group does not hold the entire equity of a subsidiary, the portion of the equity that is not owned by the group is the non-controlling interest (NCI). Paragraph 4.2(q) requires NCI to be presented in the statement of financial position within equity but separate from the equity attributable to the owners of the parent. NCI is equity of the group because the NCI does not satisfy the definition of a liability as contained in Section 2 *Concepts and Pervasive Principles.* The NCI's share of the subsidiary's equity is presented as a separate line item in the statement of financial position.

Example

Ex 53 **Entity A owns 80% of the share capital of a subsidiary (Entity B). The 20% NCI would be presented in the consolidated statement of financial position as follows:**

Extract from Entity A's consolidated statement of financial position at 31 December 20X2:

	20X2	*20X1*
Equity attributable to owners of the parent:		
Share capital	X	X
Retained earnings	X	X
	X	X
Non-controlling interest	X	X
Total equity	**X**	**X**

9.21 An entity shall disclose non-controlling interest in the profit or loss of the group separately in the statement of comprehensive income, as required by paragraph 5.6 (or in the income statement, if presented, as required by paragraph 5.7).

Notes

Paragraph 5.6 requires separate disclosure in the statement of comprehensive income, as allocations for the period, for:

(a) profit or loss for the period attributable to:
  i. non-controlling interest; and
  ii. owners of the parent.
(b) total comprehensive income for the period attributable to:
  i. non-controlling interest; and
  ii. owners of the parent.

In addition to the following example, the presentation is illustrated in Example 47.

Example

Ex 54 **Entity A has an 80% interest in a subsidiary, Entity B. The total comprehensive income and profit or loss attributable to the 20% NCI could be disclosed in the consolidated statement of comprehensive income as follows:**

Entity A's consolidated statement of comprehensive income for the year ended 31 December 20X1:

	20X1	*20X0*
	CU	*CU*
Revenue	X	X
Cost of sales	(X)	(X)
Gross profit	**X**	**X**
Distribution costs	(X)	(X)
Administrative expenses	(X)	(X)
…..		
Profit before tax	X	X
Income tax expense	(X)	(X)
Profit for the year	**X**	**X**
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Gain (loss) on translating the financial statements of foreign operations	X	(X)
Actuarial gains (losses)	(X)	X
	X	X
Items that may be reclassified subsequently to profit or loss:		
Changes in fair value of hedging instrument	X	(X)
Other comprehensive income for the year, net of tax	**X**	**X**
Total comprehensive income	**X**	**X**
Profit attributable to:		
Owners of parent	X	X
Non-controlling interest	X	X
	X	X
Total comprehensive income attributable to:		
Owners of parent	X	X
Non-controlling interest	X	X
	X	X

9.22 Profit or loss and each component of other comprehensive income shall be attributed to the owners of the parent and to the non-controlling interest. **Total comprehensive income** shall be attributed to the owners of the parent and to the non-controlling interest even if this results in the non-controlling interest having a deficit balance.

Notes

The disclosure specified above is, usually, presented in the statement of changes in equity. Example 55 illustrates one possible form of such disclosure.

Example

Ex 55 **Entity A has an 80% investment in a subsidiary (20% is held by the non-controlling interest). Profit or loss, and each component of other comprehensive income, as seen in Example 54, can be attributed to the owners of the parent and to the non-controlling interest in the consolidated statement of changes in equity as follows:**

Entity A's consolidated statement of changes in equity for the year ended 31 December 20X1:

	Attributable to equity holders of the parent						Non-controlling interest	Total equity
	Share capital	Foreign currency translation reserve	Actuarial reserve	Hedging reserve	Retained earnings	Total		
	CU	*CU*	*CU*	*CU*	*CU*	*CU*	*CU*	*CU*
Balance at 1 January 20X1	X	X	X	X	X	X	X	X
Profit for the year 20X1					X	X	X	X
Dividend declared by Entity A					(X)	(X)		(X)
Dividend declared by Entity B							(X)	(X)
Foreign currency translation difference		X				X	X	X
Defined benefit plan actuarial loss			(X)			(X)		(X)
Gain on hedge of the net investment in foreign operation				X		X		X
Balance at 31 December 20X1	X	X	X	X	X	X	X	X

Notes: (i) Comparative information must also be presented.
(ii) Amounts are only included in the NCI column to the extent that the item affects the subsidiary in which the NCI has an interest.
(iii) Each item of other comprehensive income need not be presented separately in the statement of changes in equity; they may be combined and presented as one item—presented in a single row.

Module 9—Consolidated and Separate Financial Statements

Disclosures in consolidated financial statements

9.23 The following disclosures shall be made in consolidated financial statements:

(a) the fact that the statements are consolidated financial statements;

(b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;

(c) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements; and

(d) the nature and extent of any significant restrictions (for example resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans.

Example

Ex 56 **Entity A has three subsidiaries (Entity B, Entity C and Entity D) and prepares its consolidated financial statements applying the *IFRS for SMEs* Standard.**
The information required by paragraph 9.23 could be disclosed as follows:

Note 10 Subsidiaries

These consolidated financial statements incorporate the financial statements of Entity A (parent company) and its three subsidiaries (Entity B, Entity C and Entity D). Entity B is wholly owned. The parent company owns 40% of the voting power of Entity C, but has the power to govern the financial and operating policies of Entity C under an agreement. Entity D is a wholly-owned subsidiary that operates in a foreign country and has a functional currency different to that of the other group entities.

Entities A, B and C have 31 December year-ends. Entity D, in accordance with the legislation of the jurisdiction in which it operates, has a 31 October financial year-end.

Entity D operates in Jurisdiction X. A statute in Jurisdiction X specifies that Entity D's year-end is 31 October. Consequently, Entity D prepares financial information for the year to 31 December for the purposes of preparing these consolidated financial statements.

In accordance with exchange control regulations in Jurisdiction X, Entity D is precluded from remitting more than 10% of its profit after tax outside that jurisdiction.

9.23A In addition to the disclosure requirements in Section 11, a parent entity shall disclose the carrying amount of investments in subsidiaries that are not consolidated (see paragraphs 9.3A–9.3C) at the reporting date, in total, either in the statement of financial position or in the **notes**.

Example

Ex 57 **The information required by paragraph 9.23A could be disclosed as follows:**

Note 8 Equity instruments (extract)

Included in the amount of CU15,000 (20X4—CU7,400) for equity instruments carried at fair value through profit or loss, is CU6,500 (20X4—nil) that is attributable to Entity H which was acquired as part of the acquisition of the D Group in September 20X5. Immediately following the acquisition, negotiations were started to find a buyer for Entity H. Since the end of the reporting period, the directors have completed the sale of Entity H for CU6,500.

Module 9—Consolidated and Separate Financial Statements

Separate financial statements

Presentation of separate financial statements

9.24 This Standard does not require presentation of separate financial statements for the parent entity or for the individual subsidiaries.

Notes

In some jurisdictions parent entities are required, or choose, to prepare separate financial statements in addition to consolidated financial statements. Separate financial statements are sometimes presented together with the consolidated financial statements and sometimes as a separate document. Paragraph 9.1 (which reiterates paragraph 1.7) provides that if ‘a parent entity by itself does not have public accountability, it may present its separate financial statements in accordance with [the *IFRS for SMEs* Standard], even if it presents its consolidated financial statements in accordance with full IFRS [Standards] or another set of generally accepted accounting principles’.

A parent entity assesses its eligibility to use the *IFRS for SMEs* Standard in its separate financial statements on the basis of its own public accountability without considering whether other group entities have, or the group as a whole has, public accountability (see paragraph 1.3).

9.25 Separate financial statements are a second set of financial statements presented by an entity in addition to any of the following:

(a) consolidated financial statements prepared by a parent;

(b) financial statements prepared by a parent exempted from preparing consolidated financial statements by paragraph 9.3C; or

(c) financial statements prepared by an entity that is not a parent but is an investor in an associate or has a **venturer**’s interest in a **joint venture**.

Notes

Separate financial statements are a a second set of financial statements in addition to those referred to in paragraph 9.25(a)–(c).

An entity may present separate financial statements when it elects, or is required by local regulation (for tax purposes), to do so. The *IFRS for SMEs* Standard stipulates how separate financial statements must be prepared, and some disclosures that must be included in them, but it does not in itself require separate financial statements to be presented.

If they are presented, separate financial statements are done so in addition to consolidated financial statements or other main financial statements.

Paragraph 9.26 specifies the policies to be followed in accounting for investments in subsidiaries, associates and jointly controlled entities when an entity prepares separate financial statements voluntarily or is required to do so by local regulations.

If a parent is exempt from producing consolidated financial statements under paragraph 9.3, and it also has an interest in an associate or joint venture, it will account for its investments in subsidiaries, associates and jointly controlled entities in its financial statements in accordance with the requirements in Section 11 rather than those in Section 9. These financial statements are not separate financial statements.

Module 9—Consolidated and Separate Financial Statements

Accounting policy election

9.26 When a parent, an investor in an associate or a venturer with an interest in a jointly controlled entity prepares separate financial statements and describes them as conforming to the *IFRS for SMEs*, those statements shall comply with all of the requirements of this Standard except as follows. The entity shall adopt a policy of accounting for its investments in subsidiaries, associates and **jointly controlled entities** in its separate financial statements either:

(a) at cost less impairment;

(b) at **fair value** with changes in fair value recognised in profit or loss; or

(c) using the equity method following the procedures in paragraph 14.8.

The entity shall apply the same accounting policy for all investments in a single class (subsidiaries, associates or jointly controlled entities), but it can elect different policies for different classes.

Notes

The cost and fair value accounting policy options set out in paragraph 9.26(a) and (b) are different from the cost and fair value measurement discussed in Section 14 (see paragraph 14.4) and Section 15 (see paragraph 15.9). Sections 14 and 15 apply the same cost and fair value measurement guidance as each other.

A comparison between the cost and fair value measurement requirements of Section 9 and those of Sections 14 and 15:

Accounting policy choice	Section 9	Sections 14 and 15
Cost model	Cost less impairment.	Cost less impairment but if a published price quotation is available, the investment is measured at fair value with changes recognised in profit or loss.
Fair value model	Fair value with changes recognised in profit or loss.	Fair value with changes recognised in profit or loss but, if such fair value cannot be measured reliably without undue cost or effort, the investment is measured using the cost model.

Examples—accounting policy choice

Ex 58 **Entity A has two subsidiaries. Entity A prepares its separate financial statements applying the *IFRS for SMEs* Standard. Entity A would like to adopt the following accounting policies for its investments in subsidiaries in its separate financial statements:**

- **for the subsidiary in Jurisdiction X it would like to adopt cost less impairment; and**
- **for the subsidiary in Jurisdiction Y it would like to adopt fair value with changes in fair value recognised in profit or loss.**

Entity A has two subsidiaries (two investments of the same class); it does not matter that they are based in different geographical regions or that they can be distinguished in some other way. Entity A must apply the same accounting policy for all its investments in subsidiaries; it cannot apply a different policy for each subsidiary. A single policy must be selected and applied to both investments. The policy should be either: cost less impairment; fair value with changes in fair value recognised in profit or loss; or the equity method.

Ex 59 **Entity A has one subsidiary and one associate. Entity A prepares separate financial statements applying the *IFRS for SMEs* Standard and would like to adopt the following accounting policies in those financial statements:**

- **investment in subsidiary—at cost less impairment; and**
- **investment in associate—applying the equity method.**

The cost of the investment in the subsidiary is CU100 (no impairment has been recognised for the investment); its fair value at the end of the reporting period is CU160; and applying the equity method would give a carrying amount of CU120.

The cost of the investment in the associate is CU50 (no impairment has been recognised for the investment); its fair value at the end of the reporting period is CU80; and applying the equity method would give a carrying amount of CU60.

In its separate financial statements, Entity A can choose different accounting policies for different classes of investments. Consequently, the accounting policy choices that Entity A would like to adopt are appropriate.

In this example, Entity A recognises the investment in the subsidiary at cost less impairment (CU100) and the investment in the associate using the equity method at CU60.

Disclosures in separate financial statements

9.27 When a parent, an investor in an associate or a venturer with an interest in a jointly controlled entity prepares separate financial statements, those separate financial statements shall disclose:

(a) that the statements are separate financial statements; and

(b) a description of the methods used to account for the investments in subsidiaries, jointly controlled entities and associates,

and shall identify the consolidated financial statements or other primary financial statements to which they relate.

Example—disclosures in separate financial statements

Ex 60 **Entity A has a wholly-owned subsidiary (Entity B). The group prepares consolidated financial statements applying Section 9 of the *IFRS for SMEs* Standard. In addition, Entity A is required by law to present separate financial statements.**

Extract from Entity A's separate financial statements, which are prepared applying the *IFRS for SMEs* Standard:

.....

Note X Significant accounting policies (extract)

Investment in subsidiary (Entity B)

The investment in Entity B is accounted for as an investment measured at fair value with changes in the fair value of the investment recognised in profit or loss.

Entity A's separate financial statements are presented in addition to its consolidated financial statements for 20X1.

Combined financial statements

9.28 Combined financial statements are a single set of financial statements of two or more entities under common control (as described in paragraph 19.2(a)). This Standard does not require combined financial statements to be prepared.

Notes

In the context of business combinations under common control, paragraph 19.2(a) states that common control means 'that all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.'

Combined financial statements include information about two or more entities under common control. Combined financial statements are often prepared when the controlling investor does not prepare financial statements. For example, the controlling investor could be an individual. Another reason for preparing combined financial statements is to distinguish a portion of a group from the rest of the group, because financial information about that particular portion of the group can be useful for users of the combined financial statements in making decisions. For example, a potential equity investor could be considering buying a division of an entity (which consists of two or more entities) and requires only financial information about that particular part of the group.

9.29 If the investor prepares combined financial statements and describes them as conforming to the *IFRS for SMEs*, those statements shall comply with all of the requirements of this Standard. Intercompany transactions and balances shall be eliminated; profits or losses resulting from intercompany transactions that are recognised in assets such as inventory and property, plant and equipment shall be eliminated; the financial statements of the entities included in the combined financial statements shall be prepared as of the same reporting date unless it is impracticable to do so; and uniform accounting policies shall be followed for like transactions and other events in similar circumstances.

Notes

When preparing combined financial statements, all requirements of the *IFRS for SMEs* Standard must be met. Combined financial statements must constitute a complete set of financial statements applying paragraphs 3.17–3.22. Combined financial statements present the assets, liabilities, equity, income and expenses of two or more entities controlled by the same party or parties as a single economic entity.

Similar with preparing consolidated financial statements, when preparing combined financial statements, intercompany transactions and balances are eliminated in full. Combined financial statements that include the entities under the common control of a single investor, but do not include the controlling investor itself, will generally not eliminate the capital of any of the combining entities unless the entities included in the combined financial statements have ownership in each other.

Example

Ex 61 **Mr X owns all of the share capital of both Entity A and Entity B, which are domiciled in Country Y. The presentation of combined financial statements is required by law in Country Y. Both Entity A and Entity B were established on 31 December 20X0. In the 20X1 financial year, no transactions occurred between Entities A and B.**

Statements of financial position of Entity A and Entity B at 31 December 20X1:

	Entity A		Entity B	
	20X1	*20X0*	*20X1*	*20X0*
	CU	*CU*	*CU*	*CU*
Assets				
Property, plant and equipment	–	–	500	–
Inventory	350	–	200	–
Trade receivables	280	–	–	–
Cash	400	100	680	300
Total assets	**1,030**	**100**	**1,380**	**300**
Liabilities				
Trade and other payables	300	–	700	–
Equity				
Share capital	100	100	300	300
Retained earnings	630	–	380	–
Total liabilities and equity	**1,030**	**100**	**1,380**	**300**

Statements of comprehensive income and retained earnings of Entity A and Entity B for the year ended 31 December 20X1:

	Entity A	Entity B
	CU	*CU*
Revenue	3,990	3,150
Cost of sales	(2,660)	(2,320)
Gross profit	**1,330**	**830**
Depreciation	–	(100)
Other expenses	(700)	(350)
Profit for the year	**630**	**380**
Retained earnings at start of year	–	–
Retained earnings at end of year	**630**	**380**

Statements of cash flows of Entity A and Entity B for the year ended 31 December 20X1:

	Entity A	Entity B
	CU	*CU*
Cash flows from operating activities		
Profit for the year	630	380
Adjustment for non-cash expenses:		
Depreciation of property, plant and equipment	–	100
Increase in operating assets and liabilities:		
Trade receivables	(280)	–
Inventories	(350)	(200)
Trade payables	300	100
Net cash from operating activities	**300**	**380**
Cash and cash equivalents at beginning of year	**100**	**300**
Cash and cash equivalents at end of year	**400**	**680**

Note: property, plant and equipment in Entity B (CU600) was purchased on short-term credit. This amount was outstanding at 31 December 20X1.

Combined statement of financial position at 31 December 20X1

	Entity A	Entity B	Combined
	CU	*CU*	*CU*
Assets			
Property, plant and equipment	–	500	500
Inventory	350	200	550
Trade receivables	280	–	280
Cash	400	680	1,080
Total assets	**1,030**	**1,380**	**2,410**
Liabilities			
Trade payables	300	700	1,000
Equity			
Share capital	100	300	400
Retained earnings	630	380	1,010
Total liabilities and equity	**1,030**	**1,380**	**2,410**

Combined statement of comprehensive income and retained earnings for the year ended 31 December 20X1

	Entity A	Entity B	Combined
	CU	*CU*	*CU*
Revenue	3,990	3,150	7,140
Cost of sales	(2,660)	(2,320)	(4,980)
Gross profit	**1,330**	**830**	**2,160**
Depreciation	–	(100)	(100)
Other expenses	(700)	(350)	(1,050)
Profit for the year	**630**	**380**	**1,010**
Retained earnings at start of year	–	–	–
Retained earnings at end of year	**630**	**380**	**1,010**

Combined statement of cash flows of Entity A and Entity B for the year ended 31 December 20X1

	Entity A	Entity B	Combined
	CU	*CU*	*CU*
Cash flows from operating activities			
Profit for the year	630	380	1,010
Adjustment for non-cash expenses:			
Depreciation of property, plant and equipment	–	100	100
Increase in operating assets and liabilities:			
Trade receivables	(280)	–	(280)
Inventories	(350)	(200)	(550)
Trade payables	300	100	400
Net cash from operating activities	**300**	**380**	**680**
Cash and cash equivalents at beginning of year	**100**	**300**	**400**
Cash and cash equivalents at end of year	**400**	**680**	**1,080**

Note: property, plant and equipment in Entity B (CU600) was purchased on short-term credit. This amount was outstanding at 31 December 20X1.

The columns for entities A and B in this example would not be presented in the combined financial statements.

The entities were set up on the last day of 20X0 and so there is no comparative information to be presented. However, typically, combined financial statements would show comparative information applying paragraphs 3.14 and 3.20.

Ex 62 **The facts are the same as those in Example 61 except the following transactions between Entity A and Entity B occurred:**

- **Entity B acquired inventory from Entity A for CU1,000 during 20X1. The inventory had previously cost Entity A CU800. By the end of the period, Entity B had sold all of the inventory to an external party for CU1,500.**
- **Entity B rented office space during 20X1 to Entity A in return for which Entity A paid CU100 to Entity B.**

Assume that Entity B's revenue was CU100 lower than in Example 60 (it is now CU3,050 instead of CU3,150) so that, after reflecting the rent received from Entity A, its profit for the year is the same as in Example 60.

The entries processed by Entities A and B in their individual accounting records are:

Entity A	*CU*	*CU*
Dr Asset—cash	1,000	
Cr Income—revenue		1,000
Dr Expense—cost of sales	800	
Cr Asset—inventory		800
To recognise the sale of inventory to Entity B for cash.		

Entity B	*CU*	*CU*
Dr Asset—inventory	1,000	
Cr Asset—cash		1,000
To recognise the purchase of inventory from Entity A for cash.		
Dr Asset—cash	1,500	
Cr Income—revenue		1,500
Dr Expense—cost of sales	1,000	
Cr Asset—inventory		1,000
To recognise the sale of inventory for cash.		

Entity A	*CU*	*CU*
Dr Expense—rent	100	
Cr Asset—cash		100
To recognise the rent paid in cash to Entity B.		

Entity B	*CU*	*CU*
Dr Asset—cash	100	
Cr Income—rent		100
To recognise income from rent received from Entity A in cash.		

The adjustments, in respect of the purchase of inventory, for preparing the combined financial statements at 31 December 20X1 are:

	CU	*CU*
Dr Income—revenue	1,000	
Cr Expense—cost of sales		1,000

To eliminate the effects of the transaction between Entity A and Entity B in which Entity A sold inventory to Entity B.

Entity A records a profit of CU200 (revenue from the sale of goods CU1,000 minus cost of sales CU800). Entity B records a profit of CU500 (revenue from the sale of goods CU1,500 minus cost of sales CU1,000). Total recorded profit is CU700.

In other words, profit to be recognised in the combined financial statements is CU700 (selling price to external parties CU1,500 minus cost to the group CU800). Consequently, no adjustments for profit or inventory are needed.

The adjustments, in respect of the intragroup rent, for preparing the combined financial statements at 31 December 20X1 are:

	CU	*CU*
Dr Income—rent	100	
Cr Expense—rent		100

To eliminate the effects of the transaction between Entity A and Entity B in which Entity A rented office space from Entity B.

The combined financial statements will be as follows:

Combined statement of comprehensive income and retained earnings for the year ended 31 December 20X1

	Entity A	**Entity B**	**Adjustments**	**Combined**
	CU	*CU*	*CU*	*CU*
Revenue	3,990	3,050	(1,000)	6,040
Cost of sales	(2,660)	(2,320)	1,000	(3,980)
Gross profit	**1,330**	**730**		**2,060**
Other income	–	100	(100)	–
Depreciation	–	(100)		(100)
Other expenses	(700)	(350)	100	(950)
Profit for the year	**630**	**380**		**1,010**
Retained earnings at start of year	–	–		–
Retained earnings at end of year	**630**	**380**		**1,010**

The other income of Entity B pertains to the rent income.

Combined statement of financial position at 31 December 20X1

	Entity A	Entity B	Combined
	CU	*CU*	*CU*
Assets			
Property, plant and equipment		500	500
Inventory	350	200	550
Trade receivables	280		280
Cash	400	680	1,080
Total assets	**1,030**	**1,380**	**2,410**
Liabilities			
Trade payables	300	700	1,000
Equity			
Share capital	100	300	400
Retained earnings	630	380	1,010
Total liabilities and equity	**1,030**	**1,380**	**2,410**

Combined statement of cash flows of Entity A and Entity B for the year ended 31 December 20X1

	Entity A	Entity B	Combined
	CU	*CU*	*CU*
Cash flows from operating activities			
Profit for the year	630	380	1,010
Adjustment for non-cash expenses:			
Depreciation of property, plant and equipment		100	100
Increase in operating assets and liabilities:			
Trade receivables	(280)		(280)
Inventories	(350)	(200)	(550)
Trade payables	300	100	400
Net cash from operating activities	**300**	**380**	**680**
Cash and cash equivalents at beginning of year	**100**	**300**	**400**
Cash and cash equivalents at end of year	**400**	**680**	**1,080**

Note: property, plant and equipment in Entity B (CU600) was purchased on short-term credit. This amount was outstanding at 31 December 20X1.

The columns for entities A and B in this example would not be presented in the combined financial statements.

Disclosures in combined financial statements

9.30 The combined financial statements shall disclose the following:

(a) the fact that the financial statements are combined financial statements;

(b) the reason why combined financial statements are prepared;

(c) the basis for determining which entities are included in the combined financial statements;

(d) the basis of preparation of the combined financial statements; and

(e) the **related party** disclosures required by Section 33 *Related Party Disclosures*.

Example

Ex 63 **The facts are the same as in Example 62. However, in this example Entity B purchased inventory from, and rented office space to, Mr X, the sole owner of Entities A and B (rather than from and to Entity A). The disclosures to be included in the combined financial statements could be presented as follows:**

Notes to the combined financial statements

Mr X is the sole owner of both Entity A and Entity B. Legislation of Country Y where Entity A and Entity B are domiciled requires presentation of combined financial statements for these entities.

Mr X does not control any other entities; these combined financial statements include all entities controlled by Mr X.

These financial statements are combined financial statements and represent, as if they were one single entity, the combination of two separate legal entities, Entity A and Entity B. The combined financial statements have been prepared using the financial statements of Entity A and Entity B, which were prepared as of the same reporting date. All assets, liabilities, equity, income, expenses and equity accounts of both Entity A and Entity B have been combined. The combined financial statements have been prepared using the accounting policies set out in note 2 below.

....

Related party disclosure (extract)

Mr X is the sole owner of, and controls, both Entity A and Entity B.

In 20X1 the following transactions occurred between Mr X and Entities A and B.

- Mr X sold inventory to Entity B for CU1,000. By 31 December 20X1 all of this inventory had been sold on to independent third parties.
- Mr X rented office space from Entity B for CU100.

No amounts remain outstanding at 31 December 20X1 in respect of these transactions.

Module 9—Consolidated and Separate Financial Statements

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and events often requires the exercise of judgement, including making estimates. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements—apart from those involving estimates—that its management has made when applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.
Furthermore, applying paragraph 8.7, an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the *IFRS for SMEs* Standard require disclosure of information about particular judgements and estimation uncertainties

Some of the areas where significant estimates and other judgements applying Section 9 are set out as follows.

Control

In evaluating whether an entity has control over another entity it must first be ascertained whether the controlling entity has the power to govern the financial and operating policy decisions of the other entity. Control is presumed to exist when the parent owns directly or indirectly, through subsidiaries, more than half of the voting power of an entity. However, in exceptional circumstances, such ownership may not constitute control.

Paragraph 9.5 clarifies the circumstances when an entity which owns half or less of the voting power of an entity might still have control. When control is not established through voting power, judgement may need to be applied to determine whether other factors result in control. Other factors to be considered include an agreement that specifies who governs an entity's financial and operating policies; and the existence of power to appoint or remove members of an entity's board of directors or equivalent governing body.

Useful life of goodwill

Management is required to estimate the useful life of goodwill. If management estimates that the useful life is more than ten years, management must also make a judgement as to whether this estimate is reliable. If the parent entity is unable to make a reliable estimate of the useful life of goodwill, the life shall not exceed ten years (see paragraph 19.23(a).

Consolidation procedures

When preparing consolidated financial statements, judgement must be exercised relating to the determination of amounts considered to be material for aggregation purposes. This is necessary because the amount considered to be material at a subsidiary level may differ from the amount that is considered to be material from an overall group perspective.

Further materiality considerations must be made if the parent and subsidiary entities have differing financial year-ends. In such situations, it is necessary to determine whether and what adjustments must be made when preparing consolidated financial statements.

Measurement

When a parent elects to prepare separate financial statements applying paragraph 9.25, after initial recognition an entity must measure all investments in subsidiaries using the cost model, the equity method or the fair value model.

Cost model

When the cost model or the equity method is used, significant judgements relating to accounting for any impairment of investments in a subsidiary include:

- assessing whether there is any indication that an investment in an associate may be impaired (see paragraph 27.7); and
- if there is any indication that the investment in an associate may be impaired, estimating the recoverable amount of that investment (see paragraph 27.11).

Equity method

When the equity method is used, many judgements are necessary to apply its requirements. See Module 14 for further discussion.

Fair value model

When the fair value model is adopted for measurement subsequent to initial recognition, significant judgements might be necessary in deciding which valuation model to use and determining the inputs for that model in cases where the shares in an investment are not quoted in an active market. (For application guidance on fair value measurement, see paragraphs 11.27–11.32.)

Other sections of the *IFRS for SMEs* Standard

For judgements and estimates in accounting for business combinations, see Module 19 *Business Combinations*.

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COMPARISON WITH FULL IFRS STANDARDS

When accounting for and reporting consolidated and separate financial statements for periods beginning on 1 January 2017, the main differences between the requirements of full IFRS Standards (IFRS 3 *Business Combinations*; IFRS 10 *Consolidated Financial Statements*; and IAS 27 *Separate Financial Statements*) and the *IFRS for SMEs* Standard (Section 9 *Consolidated and Separate Financial Statements*) are as follows.

Control—what to consolidate

Both full IFRS Standards and the *IFRS for SMEs* Standard use 'control' to determine what is consolidated. However, the definitions of control are different. The Glossary of terms of the *IFRS for SMEs* Standard (the Glossary) defines 'control (of an entity)' as 'The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities'. In Appendix A to IFRS 10, which was issued in 2011, control of an entity is defined thus: 'An investor controls an investee when the investor 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'. In other words, the definition in IFRS 10 consists of three elements: power; exposure to variable returns; and an investor's ability to use power to affect its amount of variable returns.

Under the *IFRS for SMEs* Standard only currently exercisable potential voting rights are considered when assessing control. Under IFRS 10 they are considered if they are substantive; in other words, the holder must have the practical ability to exercise the right. Potential voting rights may need to be considered under IFRS 10 even if they are not currently exercisable.

Requirement to prepare consolidated financial statements

A parent applying the *IFRS for SMEs* Standard need not present consolidated financial statements if the parent is itself a subsidiary and its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with full IFRS Standards or the *IFRS for SMEs* Standard. IFRS 10 sets out different conditions which specify when a parent need not present consolidated financial statements including:

- if the parent is itself a subsidiary, it must either be a wholly-owned subsidiary or, if it is only a partially-owned subsidiary, all the subsidiary's other owners must have been informed about, and not object to, the parent not presenting consolidated financial statements; and
- the ultimate parent (or any intermediate parent) must produce consolidated general purpose financial statements that comply with full IFRS Standards, not the *IFRS for SMEs* Standard.

Goodwill

Both full IFRS Standards and the *IFRS for SMEs* Standard recognise goodwill in accounting for business combinations. However, there are significant differences between the amount of goodwill recognised and its subsequent measurement (see Module 19 *Business Combinations and Goodwill*).

Non-controlling interest

Applying paragraph 19.14 of the *IFRS for SMEs* Standard, non-controlling interest is measured 'at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets.' This method is sometimes called the proportionate share method. Using this method, goodwill that is attributable to the non-controlling interest is not recognised.

Applying paragraph 19 of IFRS 3 (2008) *Business Combinations*, non-controlling interest is measured using either the full goodwill method or the proportionate share method. The difference between the two methods is that, with the full goodwill method, a non-controlling interest's stake in an entity is valued at fair value and this is used, along with consideration paid by the parent for its stake in the subsidiary, to calculate the goodwill arising on 100% of the subsidiary. The full goodwill is recognised in the consolidated financial statements (that is, it includes goodwill attributable to the non-controlling interest).

If the full goodwill method is used, at the acquisition date of a partly owned subsidiary, both goodwill and non-controlling interest are different from those calculated applying the *IFRS for SMEs* Standard.

Disposal of foreign operation that was a subsidiary

The *IFRS for SMEs* Standard prohibits any cumulative amount of exchange differences relating to a foreign operation, that were previously recognised in other comprehensive income, from being reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised. IAS 21 *The Effects of Changes in Foreign Exchange Rates* require that the amount is reclassified from equity to profit or loss (see paragraph 48 of IAS 21).

Separate financial statements

Where separate financial statements of a parent are prepared in conformity with the *IFRS for SMEs* Standard, an entity is required to adopt a policy of accounting for its investment in subsidiaries, associates and jointly controlled entities either at cost less impairment or at fair value with changes in fair value being recognised in profit or loss, or by applying the equity method.

Applying full IFRS Standards, however, an additional option exists in specified circumstances. An entity may elect to present changes in the fair value of an equity investment in other comprehensive income (instead of in profit or loss).

Combined financial statements

The *IFRS for SMEs* Standard states that combined financial statements are a single set of financial statements of two or more entities under common control (as described in paragraph 19.2(a)). Full IFRS Standards do not cover combined financial statements.

Uniform reporting period

Paragraph 9.16 of the *IFRS for SMEs* Standard requires consolidated financial statements to be prepared using the financial statements of a parent and its subsidiaries prepared as of the same reporting date 'unless it is impracticable to do so'. If it is impracticable to prepare the financial statements of a subsidiary as of the same reporting date as the parent, 'the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary, adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.' IFRS 10 has similar requirements; in addition, it specifies three months as the maximum difference between the reporting dates, and any difference between the dates of the financial statements are required to be the same from period to period.

Subsidiaries acquired and held for sale

Paragraph 9.3A of the *IFRS for SMEs* Standard provides that 'a subsidiary is not consolidated if it is acquired and is held with the intention of selling or disposing of it within one year from its acquisition date'. Such a subsidiary is accounted for in accordance with the requirements in Section 11 (at fair value through profit or loss, or if it cannot be measured without undue cost or effort, at cost less impairment). IAS 27 (2008) does not contain any exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale. Under full IFRS Standards, such subsidiaries would be measured and presented in accordance with IFRS 5 if they meet the criteria of a disposal group classified as held for sale. (In accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, assets and liabilities in a disposal group held for sale would be presented separately in the statement of financial position and the disposal group would be measured at the lower of its carrying amount and fair value less costs to sell.)

Investment retained in former subsidiary

Applying full IFRS Standards, when a parent ceases to control its former subsidiary but nevertheless continues to hold an investment in it, any such investment will be measured at fair value. That measurement will be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9, or the cost on initial recognition of an investment in an associate or joint venture, if applicable. Under paragraph 9.19 of the *IFRS for SMEs* Standard, the carrying amount 'at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial measurement of the financial asset' which is accounted for either as a financial asset in accordance with Section 11 or 12, or as investments in an associate or joint venture, in which case Section 14 or 15 applies.

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TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for preparing consolidated and separate financial statements applying the *IFRS for SMEs* Standard by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those set out beneath it.

Mark the box next to the most correct statement.

Question 1

A subsidiary is:

- ☐ (a) an entity over which an investor has significant influence.
- ☐ (b) an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as a parent).
- ☐ (c) an entity over which an investor has joint control.
- ☐ (d) an entity that has one or more associates.

Question 2

Entity A owns 30% of voting interests in Entity Z and owns convertible debt issued by Entity Z such that, if Entity A chose to convert now, it would have a 60% voting interest in Entity Z. The rights are currently exercisable.

How should Entity A account for its investment in Entity Z in its main financial statements?

- ☐ (a) consolidate Entity Z.
- ☐ (b) account for the investment in Entity Z using the equity method.
- ☐ (c) account for the investment in Entity Z at cost.

Question 3

The facts are the same as those in Question 2. Entity A prepares separate financial statements applying the *IFRS for SMEs* Standard. How should Entity A account for its investment in Entity Z in its separate financial statements? Entity A has no other investments.

- ☐ (a) at cost less accumulated impairment.
- ☐ (b) at fair value with changes in fair value recognised in profit or loss.
- ☐ (c) using the equity method.
- ☐ (d) Entity A can choose an accounting policy of either (a) or (b).
- ☐ (e) Entity A can choose an accounting policy of either (a) or (c).
- ☐ (f) Entity A can choose an accounting policy of either (a) or (b) or (c).

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Question 4

Entity A, a manufacturing company, acquired a controlling interest in a rugby club. Entity A's management decided to exclude the rugby club from consolidation on the grounds that its activities are dissimilar from those of Entity A's normal operations. How should Entity A account for its investment in the rugby club in its main financial statements?

- ☐ (a) because the activities of the rugby club are dissimilar from the activities of Entity A (manufacturing), it will be accounted for using the equity method.
- ☐ (b) because the activities of the rugby club are dissimilar from the activities of Entity A (manufacturing), it will be accounted for at cost less accumulated impairment.
- ☐ (c) the rugby club must be consolidated. There is no exception from consolidation simply because the investor and the subsidiary partake in dissimilar activities.

Question 5

Which of the following is **not** a valid condition that provides an exemption from the presentation of consolidated financial statements?

- ☐ (a) the parent is itself a subsidiary and its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with full IFRS Standards or with the *IFRS for SMEs* Standard.
- ☐ (b) the parent has no subsidiaries other than one that it acquired with the intention of selling or disposing of it within one year.
- ☐ (c) the parent is itself a subsidiary and its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with the domestic GAAP applicable in the country in which that parent operates, which is not full IFRS Standards nor the *IFRS for SMEs* Standard.

Question 6

Entity B is a venture capital organisation. Entity B holds 70% of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. In the absence of further information, Entity B must, in its main financial statements:

- ☐ (a) consolidate Entity C.
- ☐ (b) account for its investment in Entity C at its fair value with changes in fair value recognised in profit or loss.
- ☐ (c) account for its investment in Entity C at its fair value with changes in fair value recognised in other comprehensive income.
- ☐ (d) account for its investment in Entity C at cost less impairment.
- ☐ (e) choose any of the above. If Entity B decides not to consolidate Entity C (option (a)), the reasons for this decision must be disclosed.

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Question 7

Entity A owns a 60% voting interest in Entity B. Entity B owns a 70% voting interest in Entity C. How should Entity A account for its investment in Entity C in its consolidated financial statements?

☐ (a) consolidate Entity C.

☐ (b) account for its investment in Entity C using the equity method.

☐ (c) account for its investment in Entity C using the policy it has adopted to account for associates.

Question 8

The facts are the same as those in Question 7. Determine the appropriate percentage for the attribution of post-acquisition increases in Entity C's equity to Entity A.

☐ (a) 70%.

☐ (b) 60%.

☐ (c) 42%.

Question 9

Entity A owns a 60% voting interest in Entity B and a 10% voting interest in Entity C. Entity B owns a 30% voting interest in Entity C. How should Entity A account for its investment in Entity C in its consolidated financial statements?

☐ (a) as a subsidiary, because Entity A controls Entity C.

☐ (b) as an associate.

☐ (c) as an associate, if significant influence can be ascertained.

Question 10

Entity A owns a 60% voting interest in Entity B and a 10% voting interest in Entity C. Entity B owns a 50% voting interest in Entity C. How should Entity A account for its investment in Entity C in its consolidated financial statements?

☐ (a) as a subsidiary, because Entity A controls Entity C.

☐ (b) as an associate.

☐ (c) as an associate, if significant influence can be ascertained.

Question 11

Entity A owns 100% voting interest in ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity C sold inventory to Entity A (at a markup of 25% on cost) for CU125. Entity A is still holding the inventory at the end of its accounting period. At what amount should the cost of the inventory be measured in the group's consolidated financial statements?

☐ (a) CU125.

☐ (b) CU100.

☐ (c) CU75.

☐ (d) CU150.

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Question 12

In the separate financial statements of a parent entity (if presented) investments in subsidiaries are accounted for:

☐ (a) at cost less impairment.

☐ (b) using the equity method.

☐ (c) at fair value with changes in fair value recognised in other comprehensive income.

☐ (d) at fair value with changes in fair value recognised in profit or loss.

☐ (e) at cost less impairment, or using the equity method, or at fair value with changes in fair value recognised in other comprehensive income (an accounting choice).

☐ (f) at cost less impairment, or using the equity method, or at fair value with changes in fair value recognised in profit or loss (an accounting choice).

Question 13

Presentation of separate financial statements is:

☐ (a) required for a parent entity under the *IFRS for SMEs* Standard.

☐ (b) required for an individual subsidiary under the *IFRS for SMEs* Standard.

☐ (c) not required for a parent entity nor for individual subsidiaries under the *IFRS for SMEs* Standard.

Question 14

Entity A owns all the issued share capital of, and controls, Entity B. Entity B owns 70% of the issued share capital of, and controls, Entity C. In which of the following scenarios may Entity A **not** apply the *IFRS for SMEs* Standard in its separate financial statements?

☐ (a) none of the entities has public accountability and Entity A applies the local GAAP of its jurisdiction in its consolidated financial statements.

☐ (b) Entity B has public accountability and Entity A applies full IFRS Standards in its consolidated financial statements.

☐ (c) Entity A has public accountability and applies full IFRS Standards in its consolidated financial statements.

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Answers

Q1 (b)—see paragraph 9.4 and the Glossary.

Q2 (a)—see paragraph 9.6. Entity Z is a subsidiary of Entity A.

Q3 (f)—see paragraph 9.26.

Q4 (c)—see paragraph 9.8. A subsidiary is not excluded from consolidation simply because its activities are dissimilar from those of other entities within the group.

Q5 (c)—see paragraphs 9.3. The exemption applies only if the parent or ultimate parent prepares consolidated general purpose financial statements that conform with full IFRS Standards or the *IFRS for SMEs* Standard; it does not apply if they are prepared in terms of a domestic GAAP.

Q6 (a)—see paragraph 9.7. A subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation or similar entity.

Q7 (a)—see paragraph 9.5. Entity A can, through its control of Entity B, control Entity C.

Q8 (c)—although, through its control of Entity B, Entity A can control how Entity B, for example, votes on its 70% shareholding in Entity C, Entity A's proportion of Entity C's post-acquisition profits is less than 70%—this is because Entity A does not own all of Entity B. If Entity C made a distribution of CU100, only CU70 of it would be received by Entity B and if Entity B distributed this to its owners, Entity A would receive 60% of it, CU42.

Q9 (c)—Entity A would have control over 40% of the votes in Entity C—10% through its holding and 30% through its control of Entity B. Assuming that Entity A (despite having less than half the voting power of Entity C) does not control Entity C, Entity C is likely to be an associate of Entity A—but only if Entity A has significant influence over Entity C.

Q10 (a)—Entity A controls indirectly 60% of the voting interest in Entity C. It controls 10% directly and, through its control of Entity B, it controls another 50%.

Q11 (b)—see paragraph 9.15. Profit resulting from intragroup transactions that is recognised in the carrying amount of inventory is eliminated in full. The cost to Entity C of the inventory was CU100 (CU125 divided by 125%, 25% being the markup on cost).

Q12 (f)—see paragraph 9.26.

Q13 (c)—see paragraph 9.24.

Q14 (c)—see paragraph 9.1. A parent that has no public accountability may present its separate financial statements applying the *IFRS for SMEs* Standard even if it presents its consolidated financial statements applying full IFRS Standards or a local GAAP. An entity—parent or not—that has a public accountability is not allowed to present its financial statements (consolidated or otherwise) applying the *IFRS for SMEs* Standard.

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for preparing consolidated and separate financial statements in conformity with the *IFRS for SMEs* Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those set out beneath it.

Case study 1

On 1 January 20X1 SME A acquired all of the ordinary shares, which carry voting rights at a general meeting of shareholders, of SME B for CU900 in cash and obtained control of SME B on that date. At the acquisition date the statements of financial position of SMEs A and B are as follows:

Statements of financial position at 1 January 20X1:

	SME A *Carrying amount* *CU*	**SME B** *Carrying amount* *CU*
Assets		
Non-current assets		
Buildings	1,000	700
Investment in SME B	900	–
	1,900	700
Current assets		
Inventories	200	100
Trade receivables	400	300
Cash	500	150
	1,100	550
Total assets	**3,000**	**1,250**
Equity and liabilities		
Equity		
Share capital	800	600
Retained earnings	1,400	200
	2,200	800
Current liabilities		
Trade payables	800	450
	800	450
Total liabilities and equity	**3,000**	**1,250**

In this case study the fair values of SME B's assets and liabilities at 1 January 20X1 are coincidentally equal to their respective carrying amounts.

Statements of financial position at 31 December 20X1:

	SME A *Carrying amount* *CU*	SME B *Carrying amount* *CU*
Assets		
Non-current assets		
Buildings	950	670
Investment in B	900	–
	1,850	670
Current assets		
Inventories	150	120
Trade receivables	300	350
Cash	1,050	500
	1,500	970
Total assets	**3,350**	**1,640**
Equity and liabilities		
Equity		
Share capital	800	600
Retained earnings	1,650	590
	2,450	1,190
Current liabilities		
Trade liabilities	900	450
	900	450
Total liabilities and equity	**3,350**	**1,640**

Statements of comprehensive income for 20X1:

	SME A *CU*	SME B *CU*
Revenue	650	750
Cost of sales	(300)	(380)
Gross profit	**350**	**370**
Other income	50	100
Administrative expenses	(100)	(50)
Distribution expenses	(50)	(30)
Profit before tax	**250**	**390**

Required:

A. Prepare the consolidated statement of financial position as at the acquisition date and calculate goodwill, if any, to be recognised.

B. Prepare the consolidated statement of financial position and the consolidated statement of comprehensive income as at 31 December 20X1.

Note: Assume that management's best estimate of useful life is ten years and that SME A uses the straight-line amortisation method for goodwill.

For simplicity, in this case study tax has been ignored.

Answer to Case study 1

PART A

Consolidated statement of financial position at 1 January 20X1

	SME A Carrying amount CU	SME B Fair value CU	Consolidation adjustments CU	Consolidated CU
Assets				
Non-current assets				
Goodwill	–	–	100(a) [(a)]	100
Buildings	1,000	700		1,700
Investment in SME B	900	–	(900)	–
	1,900	700		1,800
Current assets				
Inventories	200	100		300
Trade receivables	400	300		700
Cash	500	150		650
	1,100	550		1,650
Total assets	**3,000**	**1,250**		**3,450**
Equity and liabilities				
Equity				
Share capital	800	600	(600)	800
Retained earnings	1,400	200	(200)	1,400
	2,200	800		2,200
Current liabilities				
Trade liabilities	800	450		1,250
	800	450		1,250
Total liabilities and equity	**3,000**	**1,250**		**3,450**

[(a)] Working for goodwill:

Consideration paid, cost of business combination	CU900
Fair value of identifiable net assets acquired	
Assets acquired at fair value, CU1,250, minus trade liabilities at fair value, CU450	800
Goodwill	CU100

PART B

Consolidated statement of financial position at 31 December 20X1

	SME A Carrying amount CU	SME B Carrying amount CU	Consolidation adjustments CU	Consolidated CU
Assets				
Non-current assets				
Goodwill	–	–	90 [a]	90
Buildings	950	670		1,620
Investment in SME B	900		(900)	–
	1,850	670		1,710
Current assets				
Inventories	150	120		270
Trade receivables	300	350		650
Cash	1,050	500		1,550
	1,500	970		2,470
Total assets	**3,350**	**1,640**		**4,180**
Equity and liabilities				
Equity				
Share capital	800	600	(600)	800
Retained earnings	1,650	590	(210) [b]	2,030
	2,450	1,190		2,830
Current liabilities				
Trade liabilities	900	450		1,350
	900	450		1,350
Total liabilities and equity	**3,350**	**1,640**	–	**4,180**

[a] Working for goodwill:
Goodwill of CU90 = goodwill at the acquisition date, CU100, minus accumulated amortisation of CU10 (CU100 ÷ 10 years).
[b] Retained earnings adjustment:
CU210 = CU200 adjustment at the acquisition date plus CU10 amortisation of goodwill.

Consolidated statement of comprehensive income for 20X1:

	SME A CU	SME B CU	Amortisation of goodwill CU	Consolidated CU
Revenue	650	750		1,400
Cost of sales	(300)	(380)		(680)
Gross profit	**350**	**370**		**720**
Other income	50	100		150
Administrative expenses	(100)	(50)	(10)	(160)
Distribution expenses	(50)	(30)		(80)
Profit before tax	**250**	**390**		**630**

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Case study 2

SME A owns all of the share capital of, and controls, SME B. During 20X1 the following intragroup transactions occurred:

1. In 20X1 SME B sold inventory for CU10,000 in cash to SME A. SME B recorded CU2,000 profit before tax on these transactions. At 31 December 20X1 SME A had not sold any of this inventory to third parties.

   The following journal entries are processed by SME A and SME B during 20X1 to account for the transaction:

SME A	*CU*	*CU*
Dr Asset—inventory	10,000	
Cr Asset—cash		10,000

SME B	*CU*	*CU*
Dr Asset—cash	10,000	
Cr Income—revenue		10,000
Dr Expense—cost of sales	8,000	
Cr Asset—inventory		8,000
Dr Expense—income tax	400	
Cr Liability—current tax		400

2. On 1 January 20X1 SME A sold inventory for CU2,000 in cash to SME B. The carrying amount of the inventory in SME A's records was CU1,600. By 31 December 20X1 SME B had sold half of this inventory to third parties for CU1,200 in cash.

   The following journal entries are processed by SME A and SME B during 20X1 to account for the transactions:

SME A	*CU*	*CU*
1 January 20X1		
Dr Asset—cash	2,000	
Cr Income—revenue		2,000
Dr Expense—cost of sales	1,600	
Cr Asset—inventory		1,600
Dr Expense—income tax	80	
Cr Liability—current tax		80

SME B	*CU*	*CU*
1 January 20X1		
Dr Asset—inventory	2,000	
Cr Asset—cash		2,000
During 20X1		
Dr Asset—cash	1,200	
Cr Income—revenue		1,200
Dr Expense—cost of sales	1,000	
Cr Asset—inventory		1,000
Dr Expense—income tax	40	
Cr Liability—current tax		40

3. On 1 January 20X1 SME B sold a building to SME A for cash of CU100,000. The building's carrying amount was CU80,000. SME A depreciates the building at a rate of 5% per year on a straight-line basis. At 1 January 20X1 the residual value of the building was estimated to be zero.

   The following journal entries are processed by SME A and SME B during 20X1 to account for the transaction:

SME A	*CU*	*CU*
1 January 20X1		
Dr Asset—property, plant and equipment	100,000	
Cr Asset—cash		100,000
31 December 20X2		
Dr Expense—depreciation	5,000	
Cr Asset—property, plant and equipment		5,000
Dr Asset—deferred tax	1,000	
Cr Expense—income tax		1,000

SME B	*CU*	*CU*
1 January 20X1		
Dr Asset—cash	100,000	
Cr Asset—property, plant and equipment		80,000
Cr Income—profit on sale of property, plant and equipment		20,000
Dr Expense—income tax	4,000	
Cr Liability—current tax		4,000

4. In 20X1 SME A rented office space to SME B. SME A invoiced SME B for CU5,000 for the year. At 31 December 20X1 SME B had not paid the amount owing in respect of the invoice.

   The following journal entries are processed by SME A and SME B during 20X1 to account for the transaction:

SME A	*CU*	*CU*
Dr Asset—trade receivable	5,000	
Cr Income—operating lease		5,000
Dr Expense—income tax	1,000	
Cr Liability—current tax		1,000

SME B	*CU*	*CU*
Dr Expense—operating lease	5,000	
Cr Liability—trade payable		5,000
Dr Asset—deferred tax	1,000	
Cr Expense—income tax		1,000

5. In December 20X1 SME B declared and paid a dividend of CU50,000 from its post-acquisition profits.

   The following journal entries are processed by SME A and SME B during December 20X1 to account for the transaction:

SME A	*CU*	*CU*
Dr Asset—cash	50,000	
Cr Income—dividends		50,000

SME B	*CU*	*CU*
Dr Equity—retained earnings	50,000	
Cr Asset—cash		50,000

Required:
In relation to the intercompany transactions detailed above, prepare the consolidation adjustments necessary to prepare the group's 31 December 20X1 consolidated financial statements and explain the reasons for these adjustments.

Assume that the applicable rate of income tax is 20%, that all income earned on the sale of assets is taxable and all expenses incurred, including the annual depreciation expense (but not the initial capital purchase), are deductible for tax purposes. For simplicity, ignore the income tax on dividends.

Answer to Case study 2

1. The consolidation adjustments required for preparing the consolidated financial statements at the end of the reporting period are:

	CU	CU
Dr Income—revenue	10,000	
Cr Expense—cost of sales		8,000
Cr Asset—inventory		2,000
Dr Asset—deferred tax	400	
Cr Expense—income tax		400
To eliminate the intragroup sale of goods and related tax effect.		

The adjustments above eliminate the effect of the intragroup sale of inventory. From the group's perspective, no external party was involved in the transaction and so no sale can be presented in the consolidated financial statements.

The CU2,000 difference between the amount of inventory recognised by SME A in its own records (CU10,000) and the amount recognised in the consolidated financial statements (CU8,000) is a deductible temporary difference (see Section 29 *Income Tax*) and it gives rise to a deferred tax asset of CU400 (20% × CU2,000) and a corresponding decrease in income tax expense. When the inventory is sold by the group to a third party in the future, this temporary difference will reverse and the related tax expense is ultimately recognised. At that point the CU2,000 profit will also be recognised.

2. The consolidation adjustments required for preparing the consolidated financial statements at the end of the reporting period are:

	CU	CU
Dr Income—revenue	2,000	
Cr Expense—cost of sales		1,800
Cr Asset—inventory		200
Dr Asset—deferred tax	40	
Cr Expense—income tax		40
To eliminate the intragroup sale of goods and related tax effect.		

The total sales recorded by SME A and SME B in their individual accounting records in respect of this inventory is CU3,200 (A's revenue of CU2,000 and B's revenue of CU1,200). The sales of the group from those inventories sold to external parties is CU1,200.

The total cost of sales recorded by SME A and SME B in their individual accounting records in respect of this inventory is CU2,600 (A's cost of sales of CU1,600 and B's cost of sales of CU1,000). The group's cost of sales is CU800 (50% of CU1,600—the actual acquisition cost of inventories).

The CU200 adjustment to inventory reflects that portion of the total profit on sale of the transferred inventory that remains in the inventory of the group at the end of the reporting period (the intercompany unrealised profit on inventory that has not been sold to a third party).

The carrying amount of the inventory is reduced by CU200. Consequently, a deferred tax asset of CU40 must be recorded on consolidation with a corresponding effect on income tax expense. The total tax expense recorded by SME A and SME B in their individual accounting records in respect of this inventory is CU120 (CU80 + CU40). Profit in the group financial statements in respect of the inventory is CU400 (CU1,200 minus CU800). Tax at 20% on this profit is CU80, which is the tax recognised in the group's consolidated statement of comprehensive income in respect of this inventory after this consolidation adjustment.

3. The consolidation adjustments required for preparing the consolidated financial statements at the end of the period are:

	CU	*CU*
Dr Income—profit on sale of property, plant and equipment	20,000	
Cr Asset—property, plant and equipment		20,000
Dr Asset—property plant and equipment	1,000	
Cr Expense—depreciation		1,000
Dr Asset—deferred tax	4,000	
Cr Expense—income tax		4,000
Dr Expense—income tax	200	
Cr Asset—deferred tax		200

To eliminate the intragroup profit on sale of property, plant and equipment and the additional depreciation expense recognised and related taxation effects.

The adjustments eliminate the increase in the building's carrying amount that is due to the intragroup sales price (CU100,000), which is greater than the original carrying amount of the building in SME B (CU80,000) and the profit recognised in SME B for the disposal of the building. Because the elimination of intercompany profit in the transfer of the building reduces its carrying amount, depreciation expense must also be adjusted. SME A recognised CU5,000 as depreciation expense based on a carrying amount of CU100,000 which includes the intercompany profit. Group depreciation expense is CU4,000 for the 12-month 20X1 reporting period (the original carrying amount of CU80,000 multiplied by 5%). Accordingly, CU1,000 (depreciation recognised by SME A of CU5,000 minus group depreciation of CU4,000) must be eliminated from the consolidated financial statements.

A deferred tax asset of CU4,000 must be recorded on consolidation with the corresponding effect on income tax expense as a result of the CU20,000 decrease in the carrying amount of the building.

The reduction in depreciation expense (CU1,000) and the corresponding increase in the group's carrying amount (as a result of a decrease in the group depreciation expense) of the building gives rise to a temporary difference in respect of tax of CU200 (CU1,000 × 20%). Accordingly the tax expense in the group's consolidated financial statements is reduced and a deferred tax credit is recognised; this is recognised as a reduction in a deferred tax asset because it is the partial reversal of the CU4,000 deferred tax asset set up in these consolidation adjustments. The CU4,000 will reverse over the 20 years, CU200 in each year.

4. The consolidation adjustments required for preparing the consolidated financial statements at the end of the reporting period are:

	CU	*CU*
Dr Liability—trade payable	5,000	
Cr Asset—trade receivable		5,000
Dr Income—operating lease	5,000	
Cr Expense—operating lease		5,000
To eliminate the intragroup operating lease.		

The consolidation adjustments eliminate all of the related operating lease rental journal entries processed by SME A and SME B, because no 'service' was rendered to a third party. The group has neither a trade receivable nor a trade payable from this transaction; it has neither rental income nor rental expenses from this transaction. It is not necessary to adjust for tax, because both entities operate in the same jurisdiction and are subject to the same rate of tax. The entries made in both entities' individual accounting records will thus offset one another in the consolidated financial statements.

5. The consolidation adjustments required for preparing the consolidated financial statements at the end of the period are:

	CU	*CU*
Dr Income—dividends	50,000	
Cr Equity—retained earnings		50,000

From the group's perspective, no dividends have been paid and no dividend revenue has been earned.