Institute of Chartered Accountants of New Zealand

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CONSOLIDATING INVESTMENTS IN SUBSIDIARIES

Issued by the Financial Reporting Standards Board
Institute of Chartered Accountants of New Zealand

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This Financial Reporting Standard is a regulation for the purposes of the Regulations (Disallowance) Act 1989

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This Financial Reporting Standard replaces parts of SSAP-8: Accounting for Business Combinations (1990). However, the corresponding parts of SSAP-8 will continue to apply to general purpose financial reports until an entity elects to comply with this Standard as permitted by the Financial Reporting Act 1993 section 27(7), or until this Standard takes effect, whichever is sooner.

This Financial Reporting Standard should be read in the context of the Explanatory Foreword to General Purpose Financial Reporting issued by the Council of the Institute of Chartered Accountants of New Zealand.

The Accounting Standards Review Board has approved FRS-37: Consolidating Investments in Subsidiaries, for the purposes of the Financial Reporting Act 1993, to apply to the following entities (as respectively defined in the Act): All reporting entities and groups, the Crown and all departments, Offices of Parliament and Crown entities, and all local authorities.

1 INTRODUCTION

COMMENTARY

1.1 This Standard deals with the preparation and presentation of consolidated financial statements. It also deals with certain disclosures relating to investments in subsidiaries in a parent’s own financial statements.

1.2 The purpose of consolidated financial statements is to report the financial performance, financial position, and cash flows of a consolidated entity that comprises a parent and those subsidiaries required to be consolidated, essentially as if all of the assets, liabilities, and activities of the parent and its consolidated subsidiaries were held, incurred, and conducted by a single entity with one or more branches or divisions. Consolidated financial statements therefore neutralise any differences in the structural form of a consolidated entity, with regard to its controlled resources and activities, for the purposes of financial reporting.

1.3 It is widely recognised that consolidated financial statements are more meaningful than the separate financial statements of the parent and its consolidated subsidiaries. They are usually necessary for a fair presentation if one entity controls the resources and activities of other entities. Any omission of relevant information about an entity's assets, whether controlled directly or indirectly, and its liabilities, revenues and expenses impairs the relevance of its financial statements.

1.4 The presentation of one set of consolidated financial statements enhances the ability of users who have an interest in the existence of the consolidated entity to assess the financial performance, financial position and cash flows of the consolidated entity, rather than having to rely solely on the separate financial statements of the individual entities.

1.5 Financial reporting standards are paragraphs in bold type-face in this Standard. Where appropriate, interpretative commentary paragraphs in plain type-face follow the financial reporting standards.

2 APPLICATION

STANDARD

2.1 This Standard applies to all entities having one or more subsidiaries.

COMMENTARY

2.2 This Standard establishes requirements that are applicable to the following financial statements of a parent having one or more subsidiaries:

(a) the parent's consolidated financial statements, with regard to measurement, presentation and disclosure requirements; and

(b) the parent's own financial statements, with regard to certain disclosure requirements in respect of investments in subsidiaries.

All references to financial statements in this Standard are to financial statements forming part of the relevant entity's general purpose financial report unless the specific context of the reference indicates otherwise.

2.3 Sometimes legislation or other requirements cause an entity to prepare financial statements for a group involving certain segments of its business that do not comprise a consolidated entity as defined in this Standard. For example, section 9(2) of the *Financial Reporting Act 1993* identifies a group entity on a geographical segment basis rather than according to the definition of a consolidated entity in this Standard. Reporting entities that do not meet the definition of a consolidated entity are not covered by this Standard because some of the principles of consolidation will not be applicable. However, such reporting entities are

encouraged to follow, to the extent possible, the principles of aggregating assets and liabilities in paragraph 5.12 and the elimination of the effects of inter-segment transactions in paragraph 5.22 of this Standard.

STANDARD

2.4 The financial reporting standards set out in this Standard apply to all financial reports where such application is of material consequence. A statement, fact, or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the financial reports are completed, is likely to influence the users of the financial report in making decisions or assessments.

2.5 This Standard applies to general purpose financial reports covering periods ending on or after 31 December 2002.

3 STATEMENT OF PURPOSE

COMMENTARY

3.1 The purpose of this Standard is to:

(a) identify the entities that are appropriate to be consolidated into consolidated financial statements for financial reporting purposes;

(b) prescribe the circumstances in which consolidated financial statements are to be presented;

(c) establish procedures for preparing consolidated financial statements that reflect the economic substance of the consolidated entity;

(d) specify minimum disclosures to be made in consolidated financial statements.

(e) specify certain disclosures relating to investments in subsidiaries in a parent's own financial statements.

4 DEFINITIONS

STANDARD

The following terms are used in this Standard with these meanings:

4.1 "Acquisition" means obtaining an asset, a group of assets, or net assets.

COMMENTARY

4.2 In the context of this Standard, an acquisition means obtaining an ownership interest in another entity. An acquisition of an ownership interest is not limited to an acquisition that gives rise to control over another entity. However, acquisitions are covered by this Standard only where an investor has control over an investee.

STANDARD

4.3 "Acquisition date" is the date on which a transferee becomes entitled to the benefits associated with an asset, a group of assets, or net assets.

COMMENTARY

4.4 In the context of this Standard, acquisition date is the date on which an ownership interest in another entity is transferred to an investor. This is the date on which there has been a transfer in substance and it is not necessarily the actual date identified in any formal sale agreement or other similar documentation.

4.5 Although the acquisition date is the specific date on which the transfer of assets occurs, the parties may, for convenience, designate a date close to that date as the acquisition date; for example, the calendar month-end that is nearest to the specific transfer date. In such case, the cost of acquisition is to be adjusted for any imputed interest corresponding to the time difference between the designated acquisition date and the actual acquisition date. However, a designated acquisition date may be treated as the actual acquisition date only where the fair values of the identifiable assets and liabilities at the designated acquisition date are not materially different to their values at the actual acquisition date.

4.6 The terms "pre-acquisition" and "post-acquisition" are to be understood in relation to the definition of acquisition date.

STANDARD

4.7 "Associate" is an investee (not being a subsidiary of the investor or joint venture entered into by the investor) over which the investor has the capacity to exercise significant influence.

COMMENTARY

4.7A Commentary providing guidance on the meaning of associate is set out in FRS-38: *Accounting for Investments in Associates*.

4.8 "Capacity" is an ability or power, whether direct or indirect, and includes an ability or power that is presently exercisable in accordance with a formal constitution, agreement, or practice, whether or not such ability or power is legally enforceable.

4.9 "Consolidated entity" is a reporting entity comprising a parent and each of its subsidiaries that are required to be consolidated in the consolidated financial statements.

COMMENTARY

4.10 A consolidated entity might not include the consolidation of all entities which

are a part of the group. Paragraph 5.5 of this Standard identifies certain subsidiaries within a group that are to be excluded from the consolidation.

STANDARD

4.11 "Consolidated financial statements" are the financial statements of the group presented without regard to the legal boundaries of the separate entities that are consolidated.

COMMENTARY

4.12 Consolidated financial statements include the assets, liabilities, revenues and expenses of the parent and its consolidated subsidiaries.

STANDARD

4.13 "Control" by one entity over another entity exists in circumstances where the following parts (a) and (b) are both satisfied:

(a) the first entity has the capacity to determine the financing and operating policies that guide the activities of the second entity, except in the following circumstances where such capacity is not required:
   (i) where such policies have been irreversibly predetermined by the first entity or its agent; or
   (ii) where the determination of such policies is unable to materially impact the level of potential ownership benefits that arise from the activities of the second entity.

(b) the first entity has an entitlement to a significant level of current or future ownership benefits, including the reduction of ownership losses, which arise from the activities of the second entity.

COMMENTARY

Control Requiring Two Elements

4.14 For control to exist for the purposes of this Standard, both parts (a) and (b) of paragraph 4.13 must be satisfied. Part (a) will be satisfied where either the capacity to determine the financing and operating policies as stated in part (a) exists, or one of the exceptions provided in items (i) and (ii) of part (a) exists. Subject to those exceptions, the definition of control requires both a power element (i.e. part (a)) and a benefit element (i.e. part (b)). It is implicit that both the power element and the benefit element are linked because ownership benefits are, by nature, benefits that arise from the determination of the relevant entity's financing and operating policies.

Ownership Form of Control

Limitation to an Ownership Form of Control

4.15 The definition of control represents control of an ownership form. An ownership form of control has been adopted as the criterion for the preparation of

consolidated financial statements because owners are the primary users of financial statements and owners primarily rely on financial statements to meet their financial information needs. Other forms of control that exist, but which are outside this definition, include:

- Control of a regulatory form that exists when there is a specific authority under regulation to impose a specified form of compliance on the regulated entity's operation.
- Control of a purchase form that exists when there is a power, held as a consequence of a relationship involving the purchase of goods or services, to compel a provider entity into a certain course of action.
- Control of a lending form that exists when there is a power, held as a consequence of a lending relationship, to compel a borrower into a certain course of action.

In-substance vs Legal Ownership

4.16 Control of an ownership form represents in-substance ownership. It includes in-substance ownership created under any scheme, arrangement, or device and is therefore not restricted to relationships that arise through the legal ownership of equity instruments. It includes all control relationships arising from any mechanism that establishes an ownership relationship between two entities including such a relationship established directly under legislation.

Regulatory vs Ownership Form of Control

4.17 Both ownership and regulatory forms of control can arise under legislation. As with ownership control, regulatory control arising under legislation establishes entitlements to benefits. However, legislation will lead to an ownership form of control only where it establishes, in favour of one entity over another, both the power to determine financing and operating policies and an entitlement to ownership benefits. The critical distinction between ownership and regulatory forms of control established under legislation is that, under the ownership form of control the entitlement to benefit arises from the power to determine financing and operating policies; whereas under the regulatory form of control, the entitlement to benefit instead arises directly from the legislation.

4.18 Regulatory forms of control are not limited to requirements currently in place. They also include the ability to enact regulation to impose future requirements. For the purposes of this Standard, the Crown's sovereign power to enact legislation is to be regarded as a regulatory form of control even though, through this power, the Crown has the capacity to establish ownership relationships as well as regulatory relationships.

Ownership vs Fiduciary Relationships

4.19 Fiduciary relationships, such as those involving trustees and beneficiaries of trusts, might appear to be ownership relationships that satisfy the definition of

control in this Standard. However, they can be distinguished in two ways:

- The decision-making power of a trustee does not meet the power element of the definition of control. While a trustee may have the ability to make decisions concerning the financing and operating activities of the trust, this ability is governed by the trustee's fiduciary responsibility at law to act in the best interests of the beneficiaries of the trust.
- A trustee's entitlement to benefits does not meet the benefit element of the definition of control. Any link between the decision-making powers of a trustee and the trustee's entitlement to benefits is different in nature to the link between the power and ownership benefit elements that exist in an ownership relationship giving rise to control. In a fiduciary relationship, the trust deed will specifically preclude a trustee from using its decision-making powers to direct the trust to engage in activities designed to increase its own fees or other benefits. Furthermore, the fee that a trustee receives will be in the nature of recompense for the services it provides as trustee, and is not a benefit attributable to the holding of an ownership interest.

Power Element

Capacity to Exercise Power through Governance

4.20 The power element refers to the capacity to determine the financing and operating policies of another entity. In most cases, with regard to entities in both the private and public sectors, such capacity exists through an ability of one entity to select and terminate those parties responsible for determining the financing and operating policies of the other entity. In the public sector, this ability is often specified by legislative authority. In the private sector, this ability mostly arises from holding a majority interest in the voting rights of the investee. The critical factor is capacity. As a consequence, where the holding of a majority interest in the voting rights of the investee determines the power element and there are favourable unexercised instruments exclusively held by the investor that will give the investor a majority interest when exercised, such interest may need to be determined on the basis that the unexercised instruments have been exercised. In the particular circumstances where such instruments exist and they are currently exercisable, such interest will need to be determined on the basis that the instruments have been exercised.

Unilateral Power

4.21 The decision-making capacity that satisfies the power element of control must be unilateral. The capacity cannot be shared or divided such that it enables power to be exercised jointly by two or more partners or co-owners. The ability to participate with others in making decisions that guide the activities of another entity usually characterises joint venture relationships, which are covered under a separate financial reporting standard. Thus, Entity A will not have a unilateral decision-making capacity with regard to Entity B if Entity A requires the ongoing

consent of other parties to set or change the policies or management that guide the activities of Entity B. On the other hand, a unilateral decision-making capacity may still exist despite there being a requirement to consult before a corresponding power can be exercised.

Restrictions on Activities

4.22 While the power element of control cannot be shared, usually it is limited to some degree by law, regulations, fiduciary responsibilities, and contractual rights of other parties. For example, provisions under the Companies Act 1993 restrict the ability of an investor in a less than wholly owned subsidiary to direct its subsidiary to engage in certain specified transactions or activities without the consent of minority shareholders. Also, contractual agreements with lenders may impose limits on an entity's ability to pay dividends. However, these forms of restrictions usually establish protective limits on, rather than participatory rights in, the decision-making capacity of the parent. Such protective limits do not usually give a minority shareholder, regulatory agency or contracting party the ability to make or participate in a parent's decisions that guide the subsidiary's activities. It is only where participatory rights are affected in addition to protective limits being placed on the entity that the power element of control may cease to be satisfied. Rights are participatory if they enable investors (majority and minority owners) to participate in decisions that involve setting and modifying the financing and operating policies that guide the activities of the entity.

Power of Veto

4.23 In some circumstances, the power element of control may appear to be satisfied where there is an ability to restrict others from directing significant policies. However, a power of veto will not of itself satisfy the power element of control unless its effect is that significant policy decisions are taken in accordance with the wishes of the entity holding that power. One entity will not have decision-making capacity with regard to another where there is a third party that has the ability to determine all significant financing and operating policies.

Delegated Power

4.24 The power element rests with the party having the ultimate decision-making capacity, regardless of whether or not the party actively exercises that capacity. The fact that decision-making ability may be delegated by one party to another party such that the second party determines the day-to-day operations of the entity does not undermine the ultimate decision-making capacity of the first party. Delegation of decision-making ability while retaining the ultimate decision-making capacity may occur in several ways, including delegation of such ability within the governance structure of the entity and delegation of such ability to an external party under a contractual arrangement.

4.25 Delegation within the governance structure of the entity includes the appointment or retention by shareholders of directors to exercise decision-making ability on the shareholders' behalf. In such case, the ultimate decision-making capacity of the shareholders continues to exist regardless of whether that capacity is exercised. For example, when a parent obtains control of a subsidiary it may choose to retain the subsidiary's existing policies, directors, officers and other personnel without affecting its ability to change any of that subsidiary's policies or personnel responsible for carrying out those policies. In the public sector, the Crown may exercise power over an entity through legislation which establishes the entity and requires the operation of that entity to have regard to the Government's policies, even though the Crown may not have day-to-day responsibility for the activities of that entity.

4.26 Delegation under a contractual arrangement includes relationships established under management agreements and franchise agreements. Under a typical management agreement, an external party is contracted to manage an entity in return for a management fee. This involves a transfer by the owner of the entity to the external party of a decision-making ability in respect of the entity. However, the ultimate decision-making capacity is retained by the owner of the entity through the ability to terminate the contract and reacquire the decision-making ability previously transferred. In a franchise agreement, the owner of a franchisee might or might not have transferred to the franchisor its decision-making ability over the franchisee. This position depends on whether, by virtue of the terms of the agreement, the franchisor is able to determine all significant financing and operating decisions affecting the franchisee. However, in all cases the ultimate decision-making capacity is retained by the owner of the franchisee through its ability to withdraw from the franchise agreement, reacquire any decision-making ability previously held by the franchisor, and continue operating in business.

Exceptions to Need for Power Element

4.27 Part (a) of paragraph 4.13 identifies two circumstances where the existence of a power element is not necessary to satisfy the definition of control. The first circumstance is where all significant policies concerning an entity have been predetermined and are unable to be modified. In such cases, even although a power element does not exist, a power element is not necessary because the party that stands to gain the ownership benefits will have been irreversibly specified in advance as part of the significant predetermined policies. Control will therefore arise in favour of any party that has established such an entity in circumstances where that party is entitled to a significant or greater level of the entity's ownership benefits. These arrangements are sometimes described as "autopilots".

4.28 The second circumstance covered by part (a) of paragraph 4.13 is where the determination of significant policies is unable to materially impact the level of

potential benefits to be realised. In such cases, a power element is not necessary because, although the policies may not be irreversibly predetermined, the nature of the activities of the entity is such that any exercise of decision-making power will have no material influence on the level of ownership benefits to be realised from those activities. For example, consider the case of a special purpose entity (SPE) established to securitise a mortgage portfolio in circumstances where the activities of the SPE are effectively limited to collecting interest income from mortgagors, paying interest income to the SPE debt holders, and paying insurance premiums to cover the risk of mortgagor default. Any party having decision-making ability concerning the SPE's activities will be unable to materially influence the net surplus or deficit of the SPE. This will instead depend substantially on factors outside the control of the manager, such as prevailing market interest rates and the cost of insurance cover. Control will therefore arise in favour of a party that is entitled to a significant or greater level of the SPE's ownership benefits, irrespective of whether that party has the ultimate decision-making capacity regarding the SPE. Entities having financial assets securitised through an SPE vehicle in this manner will commonly have control over the SPE in terms of this Standard.

Benefit Element

Entitlement to Significant Ownership Benefits

4.29 The benefit element refers to an entitlement to a significant or greater level of ownership benefits. Ownership benefits are benefits equivalent to returns to an investor on or of an investment. Where a capacity to determine the financing and operating policies of another entity exists and is relevant, ownership benefits will be directly attributable to the exercise of decisions concerning the financing and operating policies of that other entity. Types of ownership benefits are discussed in paragraphs 4.32 to 4.35 below.

4.30 A key component of the benefit element is that there be an entitlement to ownership benefits. To hold such an entitlement does not require it to be probable that ownership benefits will arise. The critical factor is that, in the event such benefits do arise, the entitled party has the ability to realise those benefits. However, a substance approach needs to be taken in assessing this factor and such an entitlement will exist only where the entitled party has a realistic ability to obtain those benefits. Entitlements to ownership benefits that are established nominally but that are never able to be obtained do not enable the benefit element to be met.

4.31 Another key component of the benefit element is that the entitlement to ownership benefits must relate to at least a significant level of such benefits. Whether a level of ownership benefits is significant often depends on the type of ownership benefits and the ability of other parties to participate in such benefits. It is not necessarily a question of meeting a predetermined percentage threshold. In

cases where percentages are an important determinant, the spread of entitlement percentages is relevant. For example, an entitlement to a level of 20% may be significant where no other parties are each entitled to more than 5%; whereas an entitlement to a level of 40% may be necessary to be significant where one or more other parties are each entitled to 20%.

Benefits from Distributions of Earnings or Net Assets

4.32 An entitlement to ownership benefits will usually arise through a residual interest in an entity that establishes an ability to participate in current or future distributions of earnings or net assets. In identifying residual interests, access to the whole of the benefit inflows arising from gross assets is not a key consideration. A parent will not have access to benefit inflows of an amount equal to those gross assets, as the creditors have a prior claim. For this reason, it is necessary to focus on the benefit flows associated with the net assets of the entity. Often evidence as to who is entitled to these benefits is given by who stands to suffer or gain from the financial performance of the entity.

Receipt of Benefits by Parent Not Required

4.33 A parent's entitlement to distributions of earnings or distributions of net assets is not dependent on whether the parent is the actual recipient of a distribution that has been made. The entitlement depends on a parent's ability to obtain the proceeds of a distribution and apply those proceeds as it determines. Therefore an entitlement to ownership benefits will continue to be held by a parent where distributions are made by a subsidiary to third parties in circumstances where the parent has the ability to claim those resources for its own purposes. Usually such circumstances will arise where the parent has expressly directed, through its capacity to determine the financing and operating policies of the subsidiary, that the transfer be made to third parties.

Other Benefits from Control over Net Assets

4.34 Ownership benefits may also comprise benefits from net assets other than residual distributions. A parent's entitlement to other ownership benefits depends on whether the power element held by the parent has been exercised to ensure that, should such other ownership benefits emerge, the benefits will flow to the parent. For example, a parent will be entitled to any synergistic benefits arising as a result of the parent using its decision-making power to combine certain functions of the parent and the subsidiary to create economies of scale.

Benefits from Complementary Activities

4.35 A parent's entitlement to other ownership benefits may also arise in circumstances where there is a supply of goods or services to a third party by the possible subsidiary, which meets an operating objective of the parent. For example, it is common for special entities such as trusts to be established to

provide certain services to support the operating objectives of another entity. In such circumstances, a parent may benefit from complementary activities. Because it can be difficult to identify clearly whether a given circumstance establishes an entitlement to receive the benefits resulting from complementary activities, this Standard takes the position that such entitlement arises when all three of the following conditions apply:

- the supply of goods or services by the possible subsidiary is directly consistent with, and is likely to enhance, the operating objectives of the parent, and
- determination of the nature of the goods or services to be supplied is a direct consequence of the exercise of the parent's decision-making ability over the activities of the possible subsidiary, and
- the parent is relieved, as a result of the activity of the possible subsidiary, of an actual or constructive obligation to provide such supply; or the parent has a right to receive a future service delivery from the possible subsidiary which is not subject to additional funding to be provided by the parent.

Responsibility for loss with or without entitlement to benefit

4.36 The term "ownership benefits" requires that a favourable result can be obtained by a parent from its ability to exercise power over the activities of another entity in order to satisfy the benefit element of control. A favourable result will include reduced deficits, in addition to increased surpluses. An entitlement to ownership benefits may exist where there is both an ability to share in any surplus and a requirement to bear any loss, but such entitlement will not exist where there is only a requirement to bear any loss. A requirement to bear any loss does not in itself diminish its entitlement to benefits from that other entity at some future point. It will only be where the requirement to bear any loss exists on its own, without a corresponding entitlement to share in any gain, that the benefit element of control will not be satisfied. The effect of entitlement to ownership benefits and a requirement to bear any loss on the benefit element of control can be summarised as follows:

(i)	entitlement to significant benefits with no exposure to loss	=	benefit element satisfied
(ii)	entitlement to significant benefits with exposure to loss	=	benefit element satisfied
(iii)	exposure to loss but no entitlement to significant benefits	=	benefit element not satisfied

4.37 The guarantee of liabilities or other obligations of an entity without any other interest or involvement in the entity is an example of a requirement to bear any loss without any entitlement to share in any surplus. While control, and therefore

consolidation, will not be applicable in such cases, the obligation to meet any such loss will need to be recognised as a provision or, unless the possibility of such loss is remote, disclosed as a contingent liability, in accordance with FRS-15: *Provisions, Contingent Liabilities and Contingent Assets.*

STANDARD

4.38 "Cost of acquisition" is the aggregate of the following amounts:

(a) the value of consideration attributable to the acquisition plus any directly attributable costs; and

(b) the fair value of the asset, group of assets, or net assets obtained as a result of the acquisition to the extent that they have been acquired through a donation or subsidy.

COMMENTARY

4.39 Commentary providing guidance on the meaning of cost of acquisition is set out in FRS-36: *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*.

STANDARD

4.40 "Discount on acquisition" is the excess of the investor's share of the fair value of the recognised identifiable assets and liabilities over the cost of acquisition.

COMMENTARY

4.41 Discount on acquisition is sometimes referred to as negative goodwill.

STANDARD

4.42 "Entity" includes any legal, administrative, or fiduciary arrangement, organisational structure, or other party.

4.43 "Equity" is the residual interest in the assets of an entity after deduction of its liabilities.

COMMENTARY

4.44 Equity is the residual interest in the net assets of an entity attributable to owners of the entity. An entitlement to this residual interest may be held through equity instruments, such as shares, where these have been issued, or through other mechanisms such as statute.

STANDARD

4.45 "Equity method" is the method of accounting whereby an investment in an investee is initially recognised at cost and is adjusted thereafter for post-acquisition changes in the investor's share of the net assets of the

investee, with:

(a) the investor's share of the net surplus or deficit of the investee recognised in the investor's statement of financial performance; and

(b) the investor's share of the total recognised revenues and expenses of the investee recognised in the investor's statement of movements in equity.

4.46 "Fair value" is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

COMMENTARY

4.47 Commentary providing guidance on the meaning of fair value in relation to acquisitions is set out in FRS-36: *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*.

STANDARD

4.48 "Goodwill" is the excess of the cost of acquisition over the investor's share of the fair value of the recognised identifiable assets and liabilities.

4.49 "Group" is an entity that comprises an investor and all of its subsidiaries.

4.50 "Identifiable assets and liabilities" consist of:

(a) the individual assets and liabilities that correspond to the acquisition, that are capable of being disposed of, or settled, individually; and

(b) planned amounts for terminating or reducing activities required to be recognised as a provision under paragraph 5.11 of FRS-36: *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*.

COMMENTARY

4.51 Commentary providing guidance on the meaning of identifiable assets and liabilities is set out in FRS-36: *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*.

STANDARD

4.52 "Investee" is an entity in which an investor has an ownership interest.

STANDARD

4.53 "Investor" is an entity that has an ownership interest in the equity of another entity or that has acquired an operation.

COMMENTARY

4.54 In the context of this Standard, an investor is limited to an entity that has an ownership interest in the equity of another entity.

STANDARD

4.55 "Minority interest" is the equity of a subsidiary other than that corresponding to the ownership interest of the investor.

COMMENTARY

4.56 Minority interest, in aggregate, is the equity of the group other than that which can be attributed to the ownership interest of the investor. It comprises residual interests in the total recognised revenues and expenses and net assets of one or more subsidiaries to the extent that the residual interests are attributable to entities other than the investor or the investor's other subsidiaries.

STANDARD

4.57 "Ownership interest" is the percentage of the equity of an investee attributable to an investor, whether the equity is attributable to the investor directly, or indirectly through its subsidiaries.

COMMENTARY

4.58 Ownership interest excludes interests, which, in substance, carry no right to participate beyond a specified amount in any distribution by the entity of either income or capital. In certain situations it may be difficult to identify the ownership interest. This is particularly the case for organisations such as trusts that do not have a well-defined ownership instrument. Instruments that give rise to interests in net assets but limit any right to participate to a specified amount will normally form part of ownership interest when the holders have an entitlement to other benefits of an ownership form. In assessing whether an entitlement exists to other ownership benefits, consideration should be given to the guidance on assessment of control set out in paragraphs 4.13 to 4.37, and 5.9 to 5.11 of this Standard.

4.59 Ownership interest in a subsidiary:

(i) may be significant in assessing whether control exists; and
(ii) is significant in determining the level of the respective parent and minority interests in the equity of the consolidated entity.

While ownership interest will always be relevant in determining the level of the respective parent and minority interests in the equity of the consolidated entity, other factors, in addition to ownership interest, will often be relevant in assessing whether control exists. In assessing the existence of the power element of control, for instance, the possible parent's level of voting power in a possible subsidiary needs to be assessed. While voting power is usually related to ownership interest, it will often signify a different level of influence or control that the investor can exercise over the investee. In all circumstances, an assessment of the existence of control should be undertaken in accordance with the guidance set out in paragraphs 4.13 to 4.37, and 5.9 to 5.11 of this Standard.

4.60 When there are unexercised instruments that are currently exercisable and that entitle a holder to obtain a further interest in a subsidiary, the ownership interest for the purposes of this Standard is the ownership interest currently held by the investor except in circumstances where the following conditions are all met:

- the options are favourable;
- the instruments are exclusively held by the investor; and
- prior to the instruments being exercised, the investor has the ability to obtain exclusively the benefits otherwise attributable to the minority interest.

STANDARD

4.61 "Parent" is an entity that controls one or more other entities.

4.62 "Significant influence" is the capacity of one entity to affect substantially, but not unilaterally determine, either or both the financial and operating policies of another entity.

COMMENTARY

4.63 Commentary providing guidance on the meaning of significant influence is set out in FRS-38: *Accounting for Investments in Associates*.

STANDARD

4.64 "Subsidiary" is an entity that is controlled by another entity.

COMMENTARY

4.65 A subsidiary may be an entity of any form that is controlled by a parent. For example, a subsidiary includes any interest held by an investor in a partnership where the investor controls that partnership.

5 FINANCIAL REPORTING

Requirement to Present Consolidated Financial Statements

STANDARD

5.1 Subject to paragraphs 5.3 and 5.5, a parent that has one or more subsidiaries at its reporting date must present consolidated financial statements in accordance with this Standard. All subsidiaries must be consolidated in such consolidated financial statements unless otherwise determined by this Standard.

COMMENTARY

5.2 The requirement to present consolidated financial statements applies only to a parent that has one or more subsidiaries as at the parent's reporting date. Where a parent has had one or more subsidiaries during the current reporting period but

does not have any subsidiaries at the reporting date, consolidated financial statements will not be prepared but additional information will need to be included in the notes to the parent's own financial statements as set out under section 6 of this Standard.

STANDARD

5.3 A parent is not required to present consolidated financial statements for the consolidated entity in which it is the parent when a provision exists under statute that expressly exempts the parent from the requirement to present consolidated financial statements.

COMMENTARY

5.4 An example of an exemption from preparing consolidated financial statements can be found in section 13(2) of the Financial Reporting Act 1993. Parent companies whose only shareholders at balance date comprise (a) an entity incorporated in New Zealand or a nominee of that entity, or (b) an entity incorporated in New Zealand and its subsidiary (or their nominees), are not required to prepare consolidated financial statements.

STANDARD

5.5 A parent must exclude from consolidation:

(a) any subsidiary for which, at the date control is obtained, the parent is obligated to relinquish control within one year; or

(b) any subsidiary for which the parent has, by the earlier of three months after the date control is obtained or the date when the annual financial statements are approved, entered into a binding arrangement to relinquish control of the subsidiary within one year from the date control is obtained; or

(c) any entity that meets any definition of a subsidiary or is otherwise described as a subsidiary, under any statute or other authority or in any context, where such entity is not subject to the control, as defined in this Standard, of the parent.

COMMENTARY

5.6 In certain circumstances it is possible for an entity to meet the definition of a subsidiary for financial reporting purposes under legislation but not meet the definition of subsidiary under this Standard. For example, when a company that is a subsidiary of another company under section 5(1) of the *Companies Act 1993* is placed in liquidation, the company ordinarily remains a subsidiary of its holding company under section 5(1), but section 248(1)(a) vests the custody and control of the company's assets in the liquidator. Without control over the assets, the holding company does not control, as defined in this Standard, the company in liquidation. Under this Standard, the company in liquidation should therefore not be consolidated.

5.7 Paragraph 5.5(c) of this Standard prohibits a parent from consolidating any entity that is not a subsidiary in terms of the definition in this Standard, even though such entity might be classified as a subsidiary elsewhere. Paragraph 5.6 gives an example of such an entity. The ability to exclude such an entity from consolidation is provided under section 14(6) of the *Financial Reporting Act 1993*. This section requires group financial statements to incorporate the financial statements of every subsidiary, 'except where otherwise required by an applicable financial reporting standard'.

STANDARD

5.8 An investment in a subsidiary that is not consolidated in accordance with paragraphs 5.5 (a) and (b) of this Standard must be disclosed as a current asset in the statement of financial position of the parent.

Assessing the Existence of Control

COMMENTARY

Application of Judgement

5.9 The existence of control as defined in this Standard is a question of fact. The determination of the fact that control exists will, however, often require the application of judgement. This is because control of an entity can be attained in a variety of ways, and the underlying circumstances will vary between differing situations. Paragraph 5.10 sets out a number of rebuttable presumptions, which, in the absence of any evidence to the contrary, will indicate the existence of control. Where a given situation does not apparently match one or more of the rebuttable presumptions, the lists of indicators of both ownership powers and ownership benefits in paragraph 5.11 may still be sufficient to establish the existence of control.

Rebuttable Presumptions

5.10 The definition of control under this Standard requires, subject to two limited exceptions, that there be both a power element and a benefit element. The circumstances listed in this paragraph establish a rebuttable presumption that control exists. A rebuttable presumption is only rebutted when there is clear evidence of control not being held by the entity in question. This evidence is likely to arise through the existence of other rebuttable presumptions, or indicators listed in paragraph 5.11, being applicable to another entity. All the circumstances listed in this paragraph should be assessed with regard to each situation.

(1) A beneficial ownership of a majority voting interest in an entity.

(2) A unilateral power to obtain a majority voting interest through ownership of securities or other rights that are currently convertible into a majority voting interest at the option of the holder where conversion is favourable to the holder.

(3) A unilateral power to appoint or remove a majority of the members of the governing body of an entity.

(4) A unilateral power, through any form of mechanism, to set or modify the financing and operating policies that guide the activities of an entity.
(5) A unilateral power to extract distributions of economic benefits from an entity.
(6) A right that is directly attributable to the ownership interest in another entity, to a majority of the economic benefits arising from that entity, irrespective of the timing or the mode of distribution of the benefits.
(7) A unilateral power to dissolve an entity and obtain a significant level of the residual economic benefits.

The use of the word "unilateral" in describing the power elements in presumptions (2), (3), (4), (5) and (7), is to be read as a discretion to exercise the particular power in the ordinary operating circumstances of the entity. As explained in paragraph 4.21, a unilateral power arises from a decision-making capacity that cannot be shared or divided. Essentially it refers to a power of a participatory nature rather than a power of a protective nature in the context of the discussion on "restrictions on activities" in paragraph 4.22.

Indicators

5.11 Where a rebuttable presumption is not apparent, the following indicators may still be sufficient to establish the existence of control. In some circumstances any one or more of these may confirm the existence of one of the rebuttable presumptions listed in paragraph 5.10, and control will then be presumed to exist. When this is not the case, an identification of control will require the existence of both a power element indicator from the first group (A) and a benefit element indicator from the second group (B). Ordinarily, for control to be evidenced in such manner, such indicators will be linked. In other words, the benefit element indicator will ordinarily either be established by a power mechanism or result from the exercise of a decision-making power attributable to the substance of a particular power element indicator. In circumstances when both power element and benefit element indicators exist in favour of more than one entity, judgement will be needed, based on all the relevant indicators and other circumstances, as to which entity is the most likely parent or whether control does not exist.

(A) Indicators of Power Element

(1) Ownership of a large minority voting interest and no other entity or organised group of entities has a significant interest.
(2) Retention of a significant minority voting interest after previously holding a majority voting interest.
(3) The holding of direct or indirect title to instruments entitling appointment of a majority of the members of the governing body of an entity.
(4) An ability demonstrated by a recent election to dominate the process of nominating candidates for the governing body of an entity and to cast a

majority of the votes cast in an election of members of that governing body.

(5) An ability to cast a majority of the votes usually cast in an election of members of the governing body of an entity.

(6) An ability to use the resources of an entity to dominate the process of nominating members of the governing body of the entity and to solicit proxies from other holders of voting power.

(7) A right to appoint members of the governing body of an entity to fill vacancies until the next election.

(8) A continuing ability to appoint a significant number of the members of the governing body of an entity for which majority appointment or election powers were previously held.

(9) An ability to determine the casting of a majority of the votes cast at a meeting of the governing body.

(10) A direct or indirect ability to determine the revenue-raising, expenditure and resource-allocation policies of another entity, including an ability to modify or approve the entity's budget or an ability to modify or approve rate or fee changes affecting revenues of the entity.

(11) A direct or indirect ability to veto, overrule or modify decisions of the governing body other than for the purpose of protecting existing legal or contractual rights or restrictions.

(12) A direct or indirect ability to appoint, hire, reassign or dismiss key management personnel of the entity.

(13) A unilateral ability to dissolve an entity and redirect the use of its individual assets, subject to claims against those assets, without assuming economic costs in excess of the expected benefits from redirection of the assets.

(B) Indicators of Benefit Element

(1) The holding of direct or indirect title to the net assets of an entity with an ongoing right to access those assets.

(2) Ability under existing regulation or other instrument to access resources of an entity for purposes determined by the entity holding such ability.

(3) A right to a significant level of the net assets of an entity in liquidation or in a distribution other than liquidation.

(4) A right to a significant level of the distributed or undistributed surpluses attributable to holders of an ownership interest.

(5) A right to a significant level of the distributed or undistributed surpluses attributable to holders of an ownership interest that would arise through the exercise of securities or other rights held that may be converted at the option of the holder without assuming risks or obligations in excess of the expected benefits from the conversion.

(6) A right to a significant level of the change in the value of net assets or the rights thereto, excluding contributions and withdrawals of members of that entity, either periodically or cumulatively, and whether received in the form

of management fees or distributions.

(7) A right to derive net cash inflows or other economic benefits from an entity under an arrangement which limits that entity to activities consistent with the activities of the entity able to derive the economic benefits.

(8) An ability to derive significant cash inflows, or other economic benefits, through an ability to use the assets of another entity.

(9) An ability to reduce the risk of incurring losses or to limit other risks associated with ownership.

(10) An ability to access cash flow synergies arising from a restructuring of the operations of either entity which occurs as a direct result of the acquisition of an ownership interest in one entity by another entity.

(11) The undertaking, by an entity, of an activity involving the supply of goods or services that is directly consistent with, and is likely to enhance, the investor's operating objectives in circumstances where:

- determination of the nature of the goods or services to be supplied is a direct consequence of the exercise by the investor of a decision-making ability over the activities of the entity; and
- the investor is relieved, as a result of the activity of the entity, of an actual or constructive obligation to provide such supply; or the investor has a right to receive a future service delivery from the entity which is not subject to additional funding to be provided by the investor.

Preparation of Consolidated Financial Statements

STANDARD

5.12 Subject to such adjustments as prescribed under this Standard, consolidated financial statements must present, as one set of combined financial statements, separate line-by-line aggregations of like items of assets, liabilities, equity, revenues, expenses and cash flows that are recognised in the financial statements of all entities in the consolidated entity.

COMMENTARY

5.13 In consolidating the financial statements of a parent and those of its subsidiaries, various adjustments may be necessary to reflect the financial performance, financial position, and financing and investing of the consolidated entity as a single entity reporting. Adjustments will be necessary to restate carrying values of identifiable assets and liabilities, to offset the parent's cost of acquisition against the relevant portion of subsidiary equity, to account for any goodwill or discount on acquisition, and to recognise any minority interest. Additional adjustments will be necessary whenever entities within a consolidated entity have had transactions with each other, where accounting policies of the subsidiary differ from those of the parent, or where there is a change in the composition of the consolidated entity.

STANDARD

5.14 For each subsidiary required to be consolidated in accordance with this Standard, a parent must consolidate financial statements of that subsidiary as from the date on which the parent obtains control over that subsidiary, and until the date on which the parent ceases to control that subsidiary.

COMMENTARY

5.15 Where a parent acquires a subsidiary, or a parent relinquishes control over a subsidiary during the reporting period, the consolidated statement of financial performance should consolidate the results of the subsidiary for that part of the reporting period during which the parent had control of the subsidiary. If, during the reporting period, an investee was an associate prior to control being obtained, or became an associate after control was relinquished, the reporting entity should apply the method prescribed for accounting for an associate to account for the results of the investee for that part of the reporting period during which the entity was an associate.

Elimination of the Cost of Acquisition

STANDARD

5.16 In preparing consolidated financial statements, any investment in the subsidiary held by the parent must be eliminated in full together with the parent's corresponding entitlement to the subsidiary's equity as at the acquisition date.

COMMENTARY

5.17 When combining the individual financial statements to prepare the consolidated financial statements, after restating (if necessary) the carrying values of identifiable assets and liabilities to reflect their fair values, a consolidation adjustment will need to be made to offset the investment asset against the corresponding portion of the subsidiary's equity as at the acquisition date. Any resulting difference is accounted for as goodwill or discount on acquisition in accordance with FRS-36*: Accounting for Acquisitions Resulting in Combinations of Entities or Operations*.

STANDARD

5.18 Where the identifiable assets and liabilities of the subsidiary are revalued in the financial statements of the subsidiary to their fair values as at the date on which the parent acquired its interest, the resulting revaluation increments or decrements must, in the consolidated financial statements, be attributed to the minority interest to the extent they are so attributable.

Minority Interest

STANDARD

5.19 Minority interest must be determined as the aggregate of the minority interests applicable to each consolidated subsidiary, after making adjustments for unrealised gains and losses of subsidiaries and such other adjustments as may be necessary to comply with the requirements set out in this Standard.

COMMENTARY

5.20 Minority interest is a component of equity of the consolidated entity attributable to equity holders other than the parent. The minority interest in the identifiable assets and liabilities of subsidiaries consists of the minority interest at the acquisition date determined in accordance with FRS-36*: Accounting for Acquisitions Resulting in Combinations of Entities or Operations*, and the minority's share of movements in equity since the acquisition date after making adjustments required by this Standard.

5.21 Where the minority interest is a negative amount (i.e. a debit balance) it should be recognised separately as a negative component of equity, except to the extent that the parent is required or agrees to bear the responsibility for any outgoings resulting from the equity deficit, in which case the negative amount would be allocated to the equity holders of the parent.

Elimination of Effects of Inter-entity Transactions

STANDARD

5.22 In preparing the consolidated financial statements, the effects of all transactions between the entities which have been consolidated must be eliminated.

COMMENTARY

5.23 When preparing the consolidated financial statements, the financial effects of transactions between entities within the consolidated entity need to be eliminated on consolidation. This is to enable the consolidated entity to be reflected as a single entity, since, for financial reporting purposes, an entity cannot transact with itself. This will be the case irrespective of whether the parent holds an ownership interest. The entity concept of consolidation, whereby the consolidated entity comprises the parent and subsidiaries which are required to be consolidated, is adopted in this Standard. Consistent with this concept, the financial effects of transactions between entities within the consolidated entity, irrespective of a minority interest, need to be eliminated in full since they are wholly within the consolidated entity. In combining the financial statements of the parent and subsidiaries which are required to be consolidated to prepare the consolidated financial statements, the effects of these transactions would be eliminated by reversing, as consolidation adjustments, the original accounting entries made to recognise the transactions.

5.24 Examples of transactions to be eliminated include:
(a) revenues/expenses from transactions between entities within the consolidated entity;
(b) balances outstanding between entities within the consolidated entity, e.g. loans; and
(c) unrealised gains and losses from transactions within the consolidated entity.

5.25 The elimination of any unrealised gains or losses should be set against the interests attributable to the parent and the minority in proportion to their ownership interests in the entity which recorded the eliminated gains or losses.

Reporting Dates
STANDARD
5.26 Consolidated financial statements must be presented for the same reporting period for which the parent's own financial statements are presented.

5.27 Wherever practicable, the financial information used for the purposes of inclusion of consolidated subsidiaries in the consolidated financial statements must cover the same reporting period as the parent's own financial statements included in the consolidated financial statements.

5.28 Where the financial information used for the purposes of inclusion of consolidated subsidiaries in the consolidated financial statements does not cover the same reporting period as that of the parent's own financial statements included in the consolidated financial statements, the following requirements must be met:
(a) the subsidiary financial information used must cover a reporting period closest to that of the parent's own financial statements;
(b) the difference between reporting dates must be no more than three months, except in rare circumstances where:
  (i) statute fixes an annual balance date of a subsidiary greater than three months from the reporting date of the parent's own financial statements included in the consolidated financial statements; and
  (ii) no reliable interim financial information for the subsidiary covering a reporting period not more than three months different to that of the parent is able to be obtained; and
(c) adjustments must be made for the effects of significant transactions or other events that occur during the portion of those reporting periods that does not overlap where such transactions or events would otherwise have been incorporated in the consolidated financial statements had the consolidated financial statements been compiled from financial information covering the same reporting periods.

COMMENTARY

5.29 When the interim or annual balance date of a subsidiary differs from the reporting date of the parent, financial information covering the same reporting period as that of the parent should normally be obtained for use in the preparation of the consolidated financial statements. If it is not practicable to obtain such financial information, the most recent subsidiary financial information able to be obtained should be used in the consolidation.

5.30 In terms of paragraph 5.29, the most recent subsidiary financial information able to be obtained for consolidation purposes will often be the information contained in the most recent interim or annual subsidiary financial statements.

5.31 In general, the most recent subsidiary financial information may be that corresponding to a reporting date subsequent to the parent's reporting date provided the inclusion, in the consolidated financial statements, of information contained in the financial statements of the subsidiary is not in breach of any express or implied legal, contractual or fiduciary obligations.

5.32 In some cases, statute, either in New Zealand or overseas, may dictate the annual balance date of either the parent or the subsidiary such that a difference in annual balance dates of over three months occurs. In such cases it is only where no reliable interim financial information for the subsidiary covering a reporting period not more than three months different to that of the parent is able to be obtained that financial statements prepared for a reporting period greater than three months different to that of the parent may be used for consolidation purposes. In these rare circumstances, the most recent reliable financial information is to be used.

5.33 When financial statements incorporated in the consolidated financial statements cover different reporting periods, it may not be possible to eliminate all inter-entity balances, and appropriate adjustments may be required to be made in the consolidated financial statements to account for any changes that have taken place in the intervening period. If such adjustments are material to the consolidated entity, it would be appropriate to provide separate note disclosure of the aggregate of the amount representing transactions that have taken place in the intervening period.

Accounting Policies

STANDARD

5.34 Unless another financial reporting standard requires a specific accounting policy to be applied by an entity in the group or by part of the group, and such policy differs from the corresponding accounting policies adopted by other entities within the group or by other parts of the group, the accounting policies employed in the preparation and presentation of consolidated financial statements must be consistent. Where the accounting policies differ

for reason other than a specific requirement of a financial reporting standard, adjustments to achieve consistency must be made in preparing the consolidated financial statements.

COMMENTARY

5.35 Since the consolidated financial statements provide financial information about a consolidated entity as a single entity, consistent accounting policies need to be adopted in the preparation of those financial statements. Where the accounting policies adopted by entities within the consolidated entity are dissimilar, adjustments need to be made in preparing the consolidated financial statements to achieve consistency, unless the dissimilar policies are required by financial reporting standards.

5.36 An example of a dissimilar policy required by a financial reporting standard in the context of paragraph 5.34 is the requirement under FRS-34: *Life Insurance Business* for a life insurer to measure all assets at net market value. Where the life insurer is a subsidiary of a non-life insurer parent which does not measure all assets at net market value, adjustments are not made to achieve consistency in preparing the consolidated financial statements.

Cross-holdings

STANDARD

5.37 In preparing the consolidated financial statements, where two entities within the **consolidated entity each hold a share of the other entity's equity, the amounts of the inter-entity investments must be eliminated.**

COMMENTARY

5.38 Adjustments for cross-holdings should be made using the treasury stock method. The treasury stock method is based on the view that entities involved in cross-holdings acquire the equivalent of a direct interest in their own net assets. Application of the treasury stock method ensures that multiple counting of net surplus and net assets does not arise. Guidance on the treasury stock method can be found in R-116: *Accounting for Companies Involved in Cross Holdings*.

STANDARD

5.39 In the circumstances set out in paragraph 5.37, in allocating the equity of the consolidated entity between the interest of the equityholders of the parent and the minority interest, the respective shares of equity must be determined after eliminating the effect of any cross-holdings between the entities within the consolidated entity.

Acquisition of an Additional Ownership Interest in a Subsidiary

STANDARD

5.40 Where a parent increases its ownership interest in an entity that is already its subsidiary, the identifiable assets and liabilities of that subsidiary must be revalued to fair value, and goodwill arising on the increase in interest must be calculated by reference to those fair values.

COMMENTARY

5.41 Where a parent increases its ownership interest in a subsidiary through the acquisition of additional equity of the subsidiary, the acquisition is accounted for as a step-acquisition of ownership interest consistent with the principles covering step-acquisitions contained in FRS-36: *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*. This requires a step-by-step comparison to be made of the cost of the individual acquisition with the investor's ownership interest in the fair values of the identifiable assets and liabilities at each step. Appendix 3 illustrates a possible approach to accounting in accordance with this requirement.

5.42 The requirement for a step-by-step comparison applies only with regard to material acquisitions. When there are a number of immaterial acquisitions, it is appropriate to group a series of such acquisitions into a single step, to treat the series in the same way as a single material acquisition.

STANDARD

5.43 Any revaluation to fair values of identifiable assets and liabilities that is recognised as a result of a parent's acquisition of additional equity of the subsidiary is exempt from the requirement for the ongoing revaluation of property, plant and equipment under FRS-3: *Accounting for Property, Plant and Equipment*.

COMMENTARY

5.44 A subsidiary that has been subject to an acquisition of additional equity by its parent may, in its own financial statements, revalue its property, plant and equipment to align the carrying values of such assets with the cost of acquisition. Alternatively, the property, plant and equipment of such subsidiary may be revalued only in the consolidated financial statements. Neither of these circumstances require the subsidiary or the group entity to continue to revalue in accordance with paragraph 7.1(b) of FRS-3: *Accounting for Property, Plant and Equipment*.

Decreases in Ownership Interest in a Consolidated Subsidiary without Loss of Control

STANDARD

5.45 Where a parent's ownership interest in a subsidiary decreases but the

parent retains control of that subsidiary, the equity of the consolidated entity must be adjusted by the net aggregate of any sale proceeds from the decrease in ownership interest less the portion of recognised goodwill attributable to the decrease in ownership interest. An expense or revenue must be recognised in the statement of financial performance of the consolidated entity to reflect any loss or gain arising from the reduction of the parent's ownership interest in the subsidiary.

COMMENTARY

5.46 Where a parent's ownership interest in a subsidiary decreases but the parent retains control, the subsidiary would continue to be part of the consolidated entity and the financial statements of the subsidiary would continue to be consolidated in the consolidated financial statements. In disclosing the equity amounts attributable to the parent and to the minority interest, the consolidated financial statements reflect the proportionate decrease in the equity of the subsidiary held by the parent and the corresponding increase in the amount attributed to the minority interest. This is illustrated in Scenario 1 of Appendix 4 of this Standard.

Loss of Control

STANDARD

5.47 Where a parent ceases to control a subsidiary, adjustments must be made on consolidation so that:

(a) the components of group equity appropriately reflect the post-acquisition equity of the subsidiary to the date of loss of control; and

(b) an expense or revenue is recognised in the statement of financial performance of the current period to reflect any resulting loss or gain to the consolidated entity arising from the loss of control.

COMMENTARY

5.48 A parent may cease to control a subsidiary as a result of a reduction in its ownership interest through disposal of its interest. It may also lose control through the issue of further subsidiary equity to the minority interest, or as a result of other circumstances such as the removal of control from the parent under regulation. As from the date control ceases, the consolidation of the former subsidiary is discontinued. In the period that control ceases, the results of the subsidiary are consolidated for only the part of the period the investor had control. In presenting the consolidated financial statements for that period, the opening equity will need to be consistent with the closing equity for the previous reporting period. In addition, an expense or revenue is recognised to reflect any gain or loss to the consolidated entity as a result of any decrease in the parent's ownership interest in the subsidiary.

5.49 In presenting the consolidated financial statements, where an investment in a previously consolidated subsidiary is retained following loss of control of the

subsidiary, the carrying amount of the investment should be adjusted to equal the carrying amount that would have been measured had the equity method been applied from acquisition date based on the ownership interest that continues to be held. If the subsidiary becomes an associate following loss of control, the equity accounting method is applied from this point based on the ownership interest retained. If the subsidiary does not become an associate following loss of control, the equity method is not applied after loss of control, and dividends from the investee are recognised as revenue to the extent that they are not already recognised in the carrying amount of the investment.

5.50 Where the loss of control is due to a decrease in the reporting entity's ownership interest, a gain or loss to the consolidated entity might occur. Where there has been a disposal of ownership interest, the gain or loss is equal to the difference between the proceeds of the sale and the consolidated subsidiary's net asset value (including any related goodwill) attributable to the percentage of ownership interest relinquished. Where the loss of control is due to other than a decrease in the reporting entity's ownership interest, there will be no gain or loss to the consolidated entity other than a possible impairment expense. This is because the carrying amount of the deconsolidated investment will include the post-acquisition increase in net assets of the investee attributable to the unchanged ownership interest. This is illustrated in Scenarios 2 and 3 of Appendix 4 of this Standard.

6 DISCLOSURES

STANDARD

6.1 The disclosure requirements in this section of the Standard apply to the consolidated financial statements, unless a requirement specifically refers to the parent's own financial statements.

6.2 The disclosure requirements prescribed under generally accepted accounting practice apply to the financial statements of any consolidated entity in the same manner as they apply to the financial statements of any entity reporting.

COMMENTARY

6.3 Financial reporting standards such as FRS-2: *Presentation of Financial Reports,* FRS-9: *Information to be Disclosed in Financial Statements,* and FRS-10: *Statement of Cash Flows* should be applied in the presentation of a parent's consolidated financial statements, where applicable. Requirements relevant to specialised forms of reporting are set out in FRS-24: *Interim Financial Statements* and FRS-29: *Prospective Financial Information.*

STANDARD

6.4 The following information in respect of each significant subsidiary must be disclosed:

(a) the subsidiary's legal name, country of incorporation if other than New Zealand and principal activities;

(b) the reporting date if different from that of the parent;

(c) the parent's ownership interest as at the subsidiary's reporting date and at the parent's reporting date (if different);

(d) the proportion of voting power held in the subsidiary if different from the ownership interest held;

(e) the amount of any interest in the net assets of the parent held by the subsidiary; and

(f) the fact that the subsidiary's financial statements reporting date changed from that used for consolidation purposes in previous years, and the effect of the change on the consolidated financial statements, if appropriate.

COMMENTARY

6.5 For the purposes of the application of paragraph 6.4, a significant subsidiary is a subsidiary that is a material component of the entity reporting in terms of either size or nature.

6.6 In assessing significance based on size, consideration should be given to the proportion of the recognised and unrecognised financial elements of the subsidiary to the corresponding financial elements of the consolidated entity. This assessment should include consideration of the impact on the consolidated financial statements of any potential transaction or event that may arise in the course of a subsidiary's activities. The impact on the consolidated entity of any potential subsidiary transaction or event is likely to be significant in any circumstances where guarantee arrangements exist which give creditors of the subsidiary access to the resources of other entities within the group that are material in the context of the group.

6.7 In assessing significance based on nature, consideration should be given to how much the activities undertaken by the subsidiary differ from those undertaken by other entities in the group. The greater the difference, the more likely it is that a subsidiary will be significant based on nature. In many cases, details of a subsidiary that undertakes different activities from other group entities will be of high information value when the subsidiary is not significant based on size, because relevant information may then be excluded from the consolidated entity's segment disclosures.

STANDARD

6.8 The following information must be separately disclosed:

(a) the legal name of any subsidiary that became part of the group during the reporting period and the corresponding date;

(b) the legal name of any subsidiary that ceased to be part of the group during the reporting period and the corresponding date;

(c) the legal name of any subsidiary in which, at the parent's reporting date, the ownership interest attributable to the parent is 50 per cent or less, together with an explanation of how control exists; and

(d) the legal name of any entity in which, at the parent's reporting date, the ownership interest attributable to the parent is more than 50 per cent but which is not a subsidiary of that parent, together with an explanation of why control does not exist.

6.9 The following information must be disclosed on an aggregate basis with regard to any change in the structure or ownership interest of the consolidated entity during the period:

(a) the increase in the individual assets and liabilities of the consolidated entity arising from the acquisition of any subsidiaries (other than temporarily controlled subsidiaries);

(b) the decrease in the individual assets and liabilities of the consolidated entity arising from the deconsolidation of any subsidiaries;

(c) the impact on the net surplus or deficit after tax of the consolidated entity as a result of the deconsolidation of subsidiaries or as a result of the acquisition of consolidated subsidiaries; and

(d) the gain or loss, if any, made by the parent and the consolidated entity on any disposal of an ownership interest in a consolidated subsidiary.

6.10 Where a parent has had one or more subsidiaries during the current reporting period but is not required to produce consolidated financial statements at the reporting date because it no longer has any subsidiaries at that date, disclosure must be made on an aggregate basis in the parent's own financial statements of the gain or loss, if any, made by the parent on loss of control of a subsidiary, showing the following components separately:

(a) the portion of post-acquisition equity of the subsidiary attributable to prior periods;

(b) the portion of post-acquisition equity of the subsidiary attributable to the current period to the point of loss of control; and

(c) the gain or loss, if any, made by the group in the current period at the point of loss of control.

COMMENTARY

6.11 In providing separate disclosure of the components of any gain or loss made by the parent in accordance with the requirement in paragraph 6.10, it will usually be appropriate to include such information in the notes to the parent's own financial statements along with an explanation that such components represent information that would have been included in consolidated financial statements for the period if the parent had continued to be required to produce consolidated financial statements. Parts (A) and (B) of Appendix 4 illustrate the relationship between the amount of any loss or gain in the parent's own financial statements and the amount of any loss or gain in the parent's consolidated financial statements.

6.12 While paragraphs 6.9 and 6.10 require the prescribed information to be shown only in aggregate, disaggregation of this information may be necessary to meet the objectives of general purpose financial reporting.

STANDARD

6.13 With respect to each significant temporarily controlled subsidiary that was acquired during the period and held as at the balance date of the parent, the following information must be disclosed:

(a) the legal name and description of the subsidiary;

(b) the reason for holding a controlling interest in the subsidiary;

(c) the carrying value of the investment in the subsidiary; and

(d) the amount attributable to the subsidiary reported within the surplus or deficiency of the group for the period.

7 TRANSITIONAL PROVISIONS

STANDARD

7.1 Comparative figures are not required to be presented in the first period of application of this Standard with regard to items required under this Standard that have not been disclosed in the entity's general purpose financial statements of the prior period.

COMMENTARY

7.2 The disclosure of comparative figures that are not required as a consequence of paragraph 7.1 is encouraged.

STANDARD

7.3 Where a subsidiary of the investor at the beginning of the period in which this Standard is first applied was consolidated at the end of the previous period and such subsidiary is required under this Standard to be consolidated, the carrying amounts of the relevant identifiable assets and liabilities and of any goodwill included in the consolidated financial statements

at the end of the period immediately prior to that in which this Standard is first applied are deemed to have been determined in accordance with this Standard.

7.4 Where a subsidiary of the investor at the beginning of the period in which this Standard is first applied was not consolidated at the end of the previous period and such subsidiary is required under this Standard to be consolidated, the carrying amounts of assets and liabilities of the consolidated financial statements must be adjusted, as at the beginning of the period in which this Standard is first applied, to those amounts that would have been the carrying amounts had the requirements of FRS-36: ***Accounting for Acquisitions Resulting in Combinations of Entities or Operations*** **been applicable when the subsidiary became a subsidiary. Any net amount of this adjustment must be recognised in the statement of movements in equity as an adjustment against equity at the beginning of the period in which this Standard is first applied and relevant portions of this amount must be included in any components of equity that are separately disclosed.**

COMMENTARY

7.5 To meet the requirements in paragraph 7.4, various approaches might be used to determine the carrying amounts, at the end of the period prior to the period in which this Standard is first applied, of a previously unconsolidated subsidiary's net assets. For example, where a subsidiary has always been wholly owned, these carrying amounts might be estimated directly by using the carrying amounts in the financial statements of the subsidiary at that time. Alternatively, where these carrying amounts are to be determined by tracing amounts back to the time(s) of the earlier acquisition(s) of ownership interest in the subsidiary, the carrying values at the date(s) of acquisition may be used as estimates of fair values at the date(s) of acquisition in meeting the requirements of FRS-36. However, the approach adopted should result in a similarly reliable determination of carrying amounts as those that would have existed had FRS-36 been the applicable standard when the subsidiary became a subsidiary.

7.6 The adjustment required by paragraph 7.4 might not necessarily result in a net adjustment to opening equity. For example, where a subsidiary covered by paragraph 7.4 has been previously accounted for under the equity method of accounting up to this time, the carrying amount of the investment and any attributable goodwill will be equal to the net total of the carrying amounts of the assets and liabilities and attributable goodwill required by paragraph 7.4 to be recognised.

STANDARD

7.7 Where an entity that was not a subsidiary of the investor at the beginning of the period in which this Standard is first applied had been

consolidated at the end of the previous period, the carrying amounts of assets and liabilities applicable to that entity and any related goodwill included in the consolidated financial statements at the end of the period immediately prior to that to which this Standard is first applied, must be reclassified as part of the carrying amount of investments.

COMMENTARY

7.8 The reclassification to an investment as required by paragraph 7.7 is made using existing balances of assets and liabilities and applicable goodwill. Accordingly, there will be no resulting net revenue or expense. In many cases, the resulting carrying amount of the investment will be the equivalent equity-accounted amount. This amount is treated as the deemed cost of the investment and it is then subsequently, as appropriate, equity accounted or accounted for as a financial instrument.

STANDARD

7.9 Where the application of this Standard as at the beginning of the period in which this Standard is first applied causes the composition of the consolidated entity previously reflected in the consolidated financial statements to change so as to include or exclude an entity or entities:

(a) the legal name of that entity or those entities must be disclosed;

(b) the aggregate net increases or decreases in assets, liabilities and equity of the consolidated entity caused by the inclusion of that entity or those entities must be separately disclosed as at the beginning of that period; and

(c) the aggregate net increases or decreases in assets, liabilities and equity of the consolidated entity caused by the exclusion of that entity or those entities must be separately disclosed as at the beginning of that period.

7.10 The Crown is not required to comply with the requirements of this Standard for reporting periods beginning on or after a date within two years following the date of first application of this Standard.

APPENDIX 1

Comparison of FRS-37 with International and Australian Accounting Standards

This comparison appendix was prepared as at 20 August 2001 and deals only with significant differences between the standards. The comparison is produced for information purposes only and does not form part of the standards in FRS-37.

Accounting standards are promulgated internationally by both the International Accounting Standards Board (IASB) and the Public Sector Committee of the International Federation of Accountants (IFAC PSC).

The International and Australian accounting standards comparable with FRS-37 are:

IASB

- IAS 22 (revised 1998): *Business Combinations*
- IAS 27 (1988): *Consolidated Financial Statements and Accounting for Investments in Subsidiaries.*

IFAC PSC

- IPSAS-6 (2000): *Consolidated Financial Statements and Accounting for Investments in Subsidiaries.*

AUSTRALIA

- AASB 1015 (1999): *Acquisition of Assets*
- AASB 1024 (1992): *Consolidated Accounts*
- AAS 21 (1985): *Accounting for the Acquisition of Assets (including Business Entities)*
- AAS 24 (1992): *Consolidated Financial Reports*
- AAS 27 (1996): *Financial Reporting by Local Governments*
- AAS 29 (1996): *Financial Reporting by Government Departments*
- AAS 31 (1996): *Financial Reporting by Governments.*

The following summarises the significant differences between the above pronouncements and FRS-37. However, please note this appendix compares requirements in the jurisdictions rather than the requirements in particular standards.

Definition of Control

FRS-37 expressly adopts a definition of control that is consistent with effective ownership and excludes control influences that arise through regulation-making power, through a purchase relationship, and through lending. The definition of control in FRS-37 also includes situations where there may not be a current capacity to exercise a decision-making power but where the decision-making has been predetermined with no party having any ongoing decision-making power and benefits to be provided have been irreversibly specified in favour of the parent. This definition is narrower regarding forms of influence, but broader regarding current capacity to influence, than the equivalent definitions and commentary provided under AASB 1024, AAS-24, AAS-27, AAS-29, AAS-31, IAS 27 and IPSAS-6.

Exceptions to Consolidation

IAS 27 and IPSAS-6 prohibit a parent from consolidating a subsidiary when the subsidiary has been acquired and continues to be held exclusively with a view to disposal in the near future. FRS-37 prohibits a parent from consolidating any subsidiary for which, at the date control is obtained, the parent is obligated to relinquish control within one year, or the parent, within three months after obtaining control, has entered into a binding arrangement to relinquish control within one year. AASB 1024 provides no exclusion for temporarily controlled subsidiaries.

IAS 27 and IPSAS-6 also prohibit a parent from consolidating a subsidiary when the subsidiary is subject to severe long-term restrictions that impair control. Severe long-term restrictions which impair control also result in exclusion from consolidation under AASB 1024 and FRS-37, however, in such circumstances, control and therefore subsidiary status is deemed not to arise under AASB 1024 and FRS-37.

Different Balance Dates

When the reporting date of a subsidiary differs from that of the parent, FRS-37, IAS 27 and IPSAS-6 all impose a maximum difference between reporting dates of three months. FRS-37 does, however, provide for an exception to the three-month difference rule in cases where statute, either in New Zealand or overseas, fixes a balance date of a subsidiary greater than three months from that of the parent; and no more recent reliable financial information is able to be obtained. AASB 1024 requires the most recent financial statements of the subsidiary to be used, without prescribing a maximum difference.

Where differences in reporting dates exist, FRS-37 also permits the most recent subsidiary financial information to be that corresponding to a reporting date subsequent to the parent's reporting date provided such information is not in

breach of any express or implied legal, contractual or fiduciary obligations. IAS 27, IPSAS-6 and AASB 1024 are silent with regard to use of subsidiary financial statements subsequent to those of the parent.

Treatment of Minority Interests

FRS-37 does not specify requirements for disclosure of minority interest. Instead, FRS-37 requires minority interest to be disclosed in accordance with other financial reporting standards. FRS-2: *Presentation of Financial Reports* and FRS-9: *Information to be Disclosed in Financial Statements* together require separate disclosure of the amounts attributable to the investor and to the minority interest in total equity, in certain components of group equity, and in certain movements in components of group equity. The requirements of FRS-2 and FRS-9 are consistent with the requirements in AASB 1024 to show separately the minority interest in group capital, group retained profits (losses), and group reserves and in group operating profit (loss) and group extraordinary items after tax. IAS 27 and IPSAS-6 require minority interests to be presented separately from both liabilities and the parent shareholders' entity, and separate presentation of minority interests in group income.

Increases or Decreases in Ownership Interest Without Loss of Control

When a further interest is acquired after control has been obtained, FRS-37 and AASB 1024 both require the adoption of a step-by-step approach which involves determination of goodwill based on the incremental interest separately and the recognition of subsidiary assets at fair values at that point. The FRS-37/ AASB 1024 approach is the same as required by FRS-36 and IAS 22 (alternative treatment) for step-acquisitions up to the point control is achieved. When an ownership interest is disposed of, or is otherwise decreased, without loss of control, FRS-37 and AASB 1024 both require recognition as revenues or expenses of any gains or losses arising.

IAS 27 and IPSAS-6 are silent regarding both accounting for step-acquisitions after control has been achieved and accounting for disposals of ownership interest in circumstances where control is retained.

Loss of Control of Subsidiaries

AASB 1024 and FRS-37 both provide extensive guidance with regard to the treatment of loss of control of subsidiaries. Both AASB 1024 and FRS-37 require recognition of any gain or loss arising on a loss of control as a revenue or expense. Where there is only a part-disposal leading to a loss of control, both standards require the continuing interest to be recognised at the equivalent equity-accounted value. IAS 27 and IPSAS-6 are silent regarding the treatment of loss of control of subsidiaries.

Appendix Guidance

AASB 1024 and FRS-37 both provide detailed appendix illustrations of treatments regarding changes in ownership interest. IAS 27 and IPSAS-6 contain no such guidance. The guidance provided in AASB 1024 is consistent with that in FRS-37.

Transitional Provisions

AASB 1024 contains several transitional provisions permitting or requiring retrospective adjustment for treatment changes resulting from the initial application of the standard. FRS-37 contains transitional requirements to achieve a correct identification of the consolidated entity at the start of the period the standard is first applied but FRS-37 does not permit or require retrospective adjustment for asset and liability and goodwill/discount values attributable to subsidiaries arising previously. FRS-37 also includes a transitional provision permitting up to a two-year delay in application of the Standard to the Crown. IAS 27 does not provide any transitional provisions. IPSAS-6 includes a transitional provision that permits entities to not eliminate all balances and transactions between entities within the economic entity for reporting periods beginning on a date within three years following the date of first adoption.

APPENDIX 2

Step-acquisitions Leading to an Additional Ownership Interest in a Subsidiary

The content of this appendix is included for illustrative purposes only and does not form part of the Financial Reporting Standard.

The following example illustrates the application of paragraph 5.40.

Acquisition of additional ownership interest in a subsidiary
Holding acquired a 90% ownership interest in Investee for $350 when the investee had net assets with a carrying value of $200, represented by share capital $60 and retained earnings $140. At date of acquisition Investee's land was worth $100 more than its carrying value of $70. As from date of acquisition Holding controlled Investee.

Some years later Holding acquired the remaining 10% ownership interest in Investee at a cost of $220, when the subsidiary's net assets had a carrying value of $1,000 (share capital $60, retained earnings $940). Its land was worth $1,000 more than its carrying value of $70.

Amortisation of goodwill is ignored for the purposes of this example.

Consolidated Statement of Financial Position at date of Second Acquisition

	Holdings	Investee	Consolidation Adjustments	Consolidated
Equity				
Contributed capital	1,000	60	60 DR	1,000
Retained earnings		940	220[1] DR	720
Revaluation reserve: land			810[2] CR	810
	1,000	1,000		2,530
Assets				
Investment in Investee	570		570 CR	-
Goodwill			100[3] DR	100
Land		70	1,000 DR	1,070
Other assets	430	930		1,360
	1,000	1,000		2,530

[1] 140 + (940 - 140) x 10%

[2] (1000 - 100) x 90%

[3] 350 - (60 + 140 + 100) x 90% = 80 (at first acquisition)
220 - (60 + 940 + 1000) x 10% = 20 (at second acquisition)
100

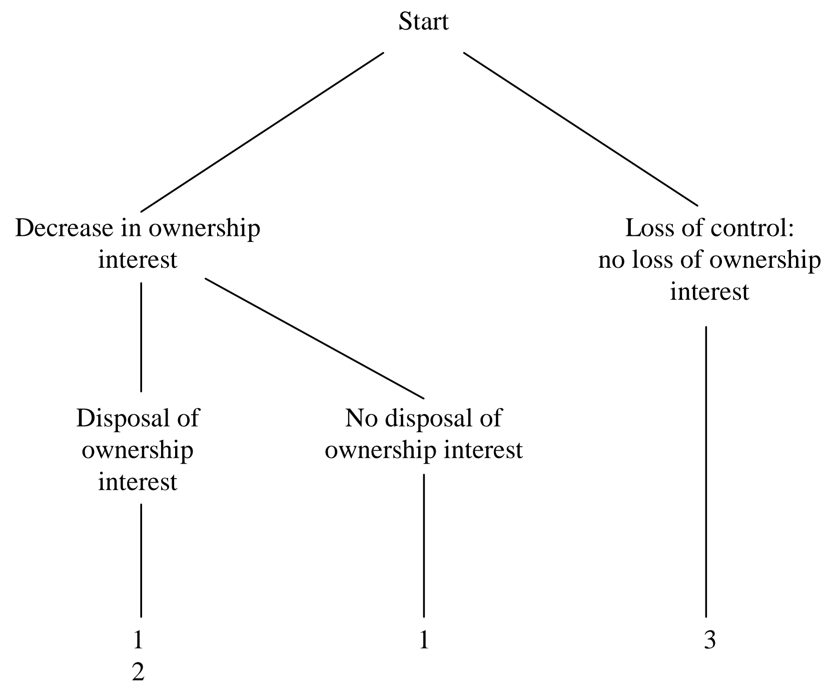
APPENDIX 3

Disposal of Ownership Interest and/or Loss of Control

The content of this appendix is included for illustrative purposes only and does not form part of the Financial Reporting Standard.

The accounting adjustments to be made in consolidated financial statements upon the decrease in ownership interest in a subsidiary and the effects of loss of control of a subsidiary are described in paragraphs 5.45 to 5.50.

(A) Chart to Determine Measurement of Gain/(Loss) upon Decrease in Ownership Interest and/or Loss of Control



Components of measurement of gain/(loss) upon loss of control:

1. The post-acquisition movement in the net assets of the subsidiary corresponding to the reduction in ownership interest.
2. The difference between (1) any proceeds of sale and (2) the initial cost of that portion of the ownership interest disposed of.
3. Possible impairment of *investment* asset.

(B) Example Illustrating Application of Paragraphs 5.45 to 5.50

The following example illustrates the impact on the consolidated financial statements of a disposal of ownership interest, or loss of control without a disposal of ownership interest.

Details of Example

Holding purchased a 100% interest in Investee for $100 when the fair value of Investee's net assets was $80, represented by share capital $60 and retained earnings $20. Investee's net assets increased by $150 since acquisition; $50 in the year of loss of control and $100 in prior years.

The three alternative scenarios are:

1. Sale of 20% ownership interest for $60 without loss of control.

2. Sale of 60% ownership interest for $300. Investee becomes an associate on loss of control.

3. There is no disposal of ownership interest but control is lost due to Investee being placed into liquidation. (To avoid any need to consider the issue of impairment, it is assumed in this scenario that the proceeds to be realised by Holding when the liquidation of Investee is complete will be equal to or greater than the value of the recognised net assets of Investee.)

Explanation of Results

Four worksheets are presented following this discussion. The first worksheet sets out the position immediately before loss of control occurs and is common to all three scenarios. Note that amortisation of goodwill from the acquisition date to the date of loss of control has been ignored.

The remaining worksheets set out the resulting group positions for each of scenarios 1 – 3 separately. Notes to the worksheets provide explanatory comment in support. For the purposes of presentation in these worksheets, it is assumed that Holding has other subsidiaries and that Holding's financial statements introduced in the consolidation worksheet represent the financial statements of the rest of the group.

Consolidation worksheet immediately prior to sale of shares

	Holdings	Investee	Consolidation Adjustments	Consolidated
Financial Position				
Equity				
Contributed capital	1,000	60	60 DR	1,000
Retained earnings		170	20 DR	150
Minority interest				
	1,000	230		1,150
Assets				
Investment in Investee Ltd	100		100 CR	
Other assets	900	230		1,130
Goodwill			20 DR	20
	1,000	230		1,150
Financial Performance				
Net surplus for the period		50		50
Movements in Equity				
Equity at start of the period	1,000	180	80 DR	1,100
Net surplus for the period		50		50
Equity at end of the period	1,000	230		1,150

Scenario 1: Sale of portion of ownership without loss of control: sold 20% ownership interest for $60

	Holdings	Recording Sale of Shares	Holdings After Sale of Shares	Investee	Consolidation Adjustments 1	Consolidation Adjustments 2	Consolidated
Financial Position							
Equity							
Contributed capital	1,000		1,000	60	60 DR		1,000
Retained earnings		40 CR	40	170	20 DR	30[2] DR	160
Minority interest						46[3] CR	46
	1,000		1,040	230			1,206
Assets							
Investment in Investee Ltd	100	20 CR	80		100 CR	20[4] DR	-
Other assets	900	60 DR	960	230			1,190
Goodwill					20 DR	4[5] CR	16
	1,000		1, 040	230			1,206
Financial Performance							
Net surplus for the period before:				50			50
Profit on sale of shares		40 CR	40[1]			30[1] DR	10[1]
							60
Movements in Equity							
Equity at start of period	1,000		1,000	180	80 DR		1,100
Net surplus for the period		40 CR	40	50		30[6] DR	60
Movement in minority interest						46[7] CR	46
Equity at end of period	1,000		1,040	230			1,206

Consolidation Adjustments

Column 1: Consolidation adjustments befor sale
2: On sale of 20% of ownership interest

[1]

Proceeds	60
Cost of shares sold (20% of 100)	20
Profit to Holdings Ltd	40
Already recognised by consolidated entity	
Retained earnings (20% of 150)	30
Profit to consolidated entity	10

[2] (100 + 50) x 20%

[3] (80 + 100+ 50) x 20%

[4] 100 x 20%

[5] 20 x 20%

[6] Profit on sale of shares already recognised by consolidated entity (see footnote 1)

[7] 20 (investment x 20%) – 4 (goodwill x 20%) + 30 (retained earnings x 20%)

Scenario 2: Sale of ownership interest resulting in loss of control: Investee becomes an associate: sold 60% of ownership interest for $300

	Holdings	Recording Sale of Shares	Holdings After Sale of Shares	Investee	Consolidation Adjustments 1	2	3	Consolidated
Financial Position								
Equity								
Contributed capital	1,000		1,000	60	60 DR			1,000
Retained earnings		240 CR	240	170	20 DR	90[2] DR		300
Minority interest						138[3] CR	138 DR	-
	1,000		1,240	230				1,300
Assets								
Investment in Investee Ltd	100	60 CR	40		100 CR	60[4] DR	100[7] DR	100
Other assets	900	300 DR	1,200	230			230 CR	1,200
Goodwill					20 DR	20[5] CR		-
	1,000		1, 240	230				1,300
Financial Performance								
Net surplus for the period before:				50				50
Gain on sale of shares		240 CR	240[1]				90[1] DR	150[1]
								200
Movements in Equity								
Equity at start of period	1,000		1,000	180			80[8] DR	1,100
Net surplus for the period		240 CR	240	50		90[6] DR		200
Equity at end of period	1,000		1, 240	230				1,300

Consolidation Adjustments

Column 1: Consolidation adjustments
Column 2: On sale of 60% of ownership
Column 3: From consolidation to equity accounting

1

Proceeds	300
Cost of shares sold (60% of 100)	60
Profit to Holding Ltd	240
Already recognised by consolidated entity retained earnings (60% of 150)	90
Profit to consolidated entity	150

2 (100 + 50) x 60%

3 (80 + 100+ 50) x 60%

4 100 x 60%

5 In accordance with FRS-38, para 5.9, the goodwill of 8 (20 x 40%) attributable to the continuing associate is not separately recognised. Instead, it is included in the carrying amount of the investment.

6 (100 + 50) x 60%

7 40 (investment, at cost x 40%) + 60 (post-acquisition earnings x 40%). This amount includes goodwill of 8 (20 x 40%).

8 60 + 20 (at acquisition)

Scenario 3: No change in ownership but loss of control because Investee is in liquidation

	Holdings	Investee	Before Investee placed in liquidation		After Investee placed in liquidation	
			Consolidation Adjustments	Consolidated	Deconsolidation Adjustments	Consolidated
Financial Position						
Equity						
Contributed capital	1,000	60	60 DR	1,000		1,000
Retained earnings		170	20 DR	150		150
Minority interest						
	1,000	230		1,150		1,150
Assets						
Investment in Investee Ltd	100		100 DR		250 DR	250[2]
Other assets	900	230		1,130	230 CR	900
Goodwill			20 DR	20	20 CR	
	1,000	230		1,150		1,150
Financial Performance						
Net surplus for the period		50		50		50[1]
Movements in Equity						
Equity at start of the period	1,000	180	80[3] DR	1,100		1,100
Net surplus for the period		50		50		50[1]
Equity at end of the period	1,000	230		1,150		1,150

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[1] Earned by Investee during consolidation period.

[2] Subject to impairment test re likely distribution on liquidation.

[3] 60 + 20 (at acquisition).

History

FRS-37: *Consolidating Investments in Subsidiaries* (revised October 2002 and effective for periods ending on or after 31 December 2002) amended as follows: deletion of Appendix 2, changes to paragraph 4.37 and consequential changes to paragraph 5.9.

FRS-37: *Consolidating Investments in Subsidiaries* (issued October 2001 and effective for periods ending on or after 31 December 2002).

SSAP-8: *Accounting for Business Combinations* (revised October 1990 and effective for periods commencing on or after 1 January 1991).

SSAP-8: *Accounting for Business Combinations* (issued October 1987 and effective for periods commencing on or after 1 January 1988).

FRS-37