Australian Accounting Standard **AAS 24**

May 1992

Consolidated Financial Reports

Prepared by the **Public Sector Accounting Standards Board** of the **Australian Accounting Research Foundation** and by the **Australian Accounting Standards Board**

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AUSTRALIAN ACCOUNTING STANDARD

AAS 24 "CONSOLIDATED FINANCIAL REPORTS"

Citation

1 This Standard may be cited as Australian Accounting Standard AAS 24 "Consolidated Financial Reports".

Accounting Standards and Commentary

STANDARDS

2 **The accounting standards set out in this Standard are shown in bold print. Commentary is shown in normal print immediately after the accounting standards to which it relates, as an aid to the interpretation of those accounting standards.**

Application and Operative Date

STANDARDS

3 **This Standard applies to general purpose financial reports of each entity to which accounting standards operative under the Corporations Law do not apply that is the parent entity in an economic entity which is a reporting entity, in relation to the economic entity's first reporting period that ends on or after 30 June 1992 and later reporting periods. When operative, this Standard supersedes Australian Accounting Standard AAS 24 "Consolidated Financial Reports" as issued in September 1991.**

4 **When a parent entity prepares a financial report which it purports to be a general purpose financial report for an economic entity which is not a reporting entity, it shall apply this Standard as if the economic entity is a reporting entity.**

COMMENTARY

5 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. A parent entity which is not required to apply Accounting Standards operative under the Corporations Law is required to apply this Standard if the economic entity is a reporting entity.

Applying the Standard to economic entities

COMMENTARY

6 Adoption of the criterion of control for defining an economic entity has significant implications in respect of the parent entity/ subsidiary relationships identified in accordance with this Standard and the legal form of the entities involved. Adoption of the criterion of control will enable a complete economic entity to be reflected in a consolidated financial report even though, for example, some of the subsidiaries may be in the form of partnerships or trusts.

7 This Standard requires the presentation of consolidated financial reports for each economic entity which can be identified as a reporting entity. The economic entity would comprise the parent entity and each of the entities under its control and in the public sector could include, for instance, government agencies, authorities, companies, partnerships and trusts. Where a general purpose financial report involves the combination of the financial reports of a number of entities, this Standard requires that the general purpose financial report comprise a consolidated financial report prepared in accordance with the consolidation techniques set out herein. This Standard does not address whether consolidated financial reports ought to be prepared at the whole-of-government level for each State and Territory and the Federal Government. Consideration of the content and form of reporting for whole-of-government is currently being addressed in a separate project.

8 There may be circumstances where an economic entity is not a reporting entity as defined in this Standard. This might occur, for instance, where the economic entity is within another economic entity which is a reporting entity. Where an economic entity is not a reporting entity, the preparation of consolidated financial reports for that entity is not required by this Standard.

Claims for exclusion from scope of the Standard

COMMENTARY

9 It is sometimes argued that in certain circumstances parent entity/ subsidiary relationships should be exempted from the requirement to prepare consolidated financial reports. However, the adoption in this Standard of control as the criterion for determining a parent entity/subsidiary relationship enables identification of an economic entity for which consolidated financial reports may be prepared and, provided the economic entity is a reporting entity, no exemptions from the standards set out in this Standard are justified.

Some commonly suggested exclusions are identified below and explanations are provided as to why they do not constitute exclusions from the standards set out in this Standard.

Temporary control

COMMENTARY

10 Temporary control does not of itself affect the economic entity for which consolidated financial reports are to be prepared. During the time that control is held and until such time as control ceases, the subsidiary is part of the economic entity and needs to be reflected in the consolidated financial reports.

Impaired control

COMMENTARY

11 The existence of severe restrictions which impair control means that the consolidation criterion is not satisfied and would result in the entity in question no longer being part of the economic entity. This would include, for instance, where a subsidiary is located in a country in which the government has undertaken certain actions, such as adopting legislation to provide for expropriation of the assets of the subsidiary, which impair control by the parent entity. Another example would be where a subsidiary is in the process of being liquidated. While the existence of such restrictions would generally constitute an impairment of the parent entity's control, each case would need to be assessed in the light of the prevailing circumstances. No exclusion or exemption is necessary where control is impaired since consolidation of the entity in these circumstances would contravene the standards set out in this Standard.

Dissimilar activities

COMMENTARY

12 Where the activities of entities within the economic entity are dissimilar it is sometimes claimed that aggregation of the financial report of each of the component entities may reduce the usefulness of the consolidated financial report. However, since the objective in preparing consolidated financial reports is to reflect the economic entity as a single reporting entity, it does not matter whether the entities comprising the economic entity are involved in dissimilar activities. Where economic entities are involved in dissimilar activities, the extent of this involvement can be conveyed in consolidated financial reports by the provision of disaggregated

information on the various lines of activity. Australian Accounting Standard AAS 16 "Financial Reporting by Segments" provides guidance on the provision of information about significant industry and geographical segments. In the case of non-business entities which are not companies, the presentation of disaggregated information on a functional or program basis may be more relevant.

Parent entity holds a minority ownership interest in a subsidiary

COMMENTARY

13 Exemption from the requirement to include a subsidiary in a consolidated financial report is also sometimes proposed where the parent entity does not hold a majority ownership interest in the subsidiary. However, because control rather than ownership interest is the consolidation criterion in this Standard, the absence of a majority ownership interest does not affect the economic entity or the requirement to prepare a consolidated financial report, provided that control exists. The extent of the parent entity's ownership interest in the subsidiary will be evident from the equity disclosures in the consolidated financial report.

Statement of Purpose

STANDARDS

14 **The purpose of this Standard is to:**

(a) identify for financial reporting purposes parent entities and subsidiaries; and

(b) prescribe the circumstances in which consolidated financial reports are to be prepared and the financial information to be included in those reports;

so that the consolidated financial reports reflect the performance, financial position and financing and investing of a group of related entities as a single economic entity.

COMMENTARY

15 In this Standard, the concept of the reporting entity is extended from the legal entity or other single entity to recognise the existence of an economic entity stemming from interrelationships between entities. The objective underlying the preparation of financial reports for this economic entity is to provide relevant and reliable financial information about the related entities as a single reporting

entity to reflect that these entities operate as a single economic unit. For a number of entities to be able to operate together as a single economic unit, they need to be under common direction, thereby providing consistency in the objectives being pursued. This occurs when entities are related by being under the common control of one entity. Hence, in this Standard it is contended that it is control rather than ownership that provides the criterion which is fundamental to identification of the group of related entities for which the presentation of consolidated financial reports is required. The preparation of consolidated financial reports for this economic entity is consistent with Statement of Accounting Concepts SAC 2 "Objective of General Purpose Financial Reporting", which states that general purpose financial reports shall provide information useful to users for making and evaluating decisions about the allocation of scarce resources.

Application of Materiality

STANDARDS

16 **The accounting standards set out in this Standard shall, in accordance with Australian Accounting Standard AAS 5 "Materiality in Financial Statements", apply to consolidated financial reports where such application is of material consequence. Information in a consolidated financial report is material if its omission, non-disclosure or misstatement has the potential to adversely affect:**

(a) decisions about the allocation of scarce resources made by users of the consolidated financial report; or

(b) the discharge of accountability by managements and governing bodies.

COMMENTARY

17 In deciding whether an item is material, its nature and amount usually need to be evaluated together.

Definitions

STANDARDS

18 **In this Standard:**

"capacity" means ability or power, whether direct or indirect, and includes ability or power that is presently exercisable as a

result of, by means of, in breach of, or by revocation of, any of or any combination of the following:

(a) trusts;

(b) relevant agreements; and

(c) practices;

whether or not enforceable;

"control" means the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity;

"economic entity" means a group of entities comprising the parent entity and each of its subsidiaries;

"entity" means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives;

"financial report" includes any consolidated financial report;

"general purpose financial report" means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs;

"outside equity interest" means the equity in the economic entity other than that which can be attributed to the ownership group of the parent entity;

"ownership interest" means the capital held by an entity directly, and/or indirectly through another entity;

"parent entity" means an entity which controls another entity;

"recognised" means reported on, or incorporated in amounts reported on, the face of the profit and loss or other operating statement or of the statement of financial position (whether or not further disclosure of the item is made in notes thereto);

"reporting date" means the end of the reporting period to which the financial report relates;

"reporting entity" means an entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources; and

"subsidiary" means an entity which is controlled by a parent entity.

Reporting entities

COMMENTARY

19 Paragraphs 19 to 37 of Statement of Accounting Concepts SAC 1 "Definition of the Reporting Entity" provide guidance for determining whether an entity is a reporting entity. An entity is not a reporting entity merely because it prepares a financial report pursuant to legislation or some other requirement.

20 Miscellaneous Professional Statement APS 1 "Conformity with Statements of Accounting Concepts and Accounting Standards" requires general purpose financial reports to be prepared in accordance with Accounting Standards and Statements of Accounting Concepts. APS 1 also requires that to the extent of any incompatibility between an Accounting Standard and a Statement of Accounting Concepts, the requirements of the Standard prevail.

Control

COMMENTARY

21 Whether an entity has control of another entity will always be a question to be decided in the light of the prevailing circumstances. The definition of control depends upon substance rather than form and, accordingly, determination of the existence of control will involve the preparer of the financial reports in exercising professional skill and judgement.

22 Any of the following factors would normally indicate the existence of control by one entity of another entity:

(a) the capacity to dominate the composition of the board of directors or governing board of another entity;

(b) the capacity to appoint or remove all or a majority of the directors or governing members of another entity;

(c) the capacity to control the casting of a majority of the votes cast at a meeting of the board of directors or governing board of another entity;

(d) the capacity to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of another entity, irrespective of whether the capacity is held through shares or options; and

(e) the existence of a statute, agreement, or trust deed, or any other scheme, arrangement or device, which, in substance, gives an entity the capacity to enjoy the majority of the benefits and to be exposed to the majority of the risks of that entity, notwithstanding that control may appear to be vested in another party.

23 Another factor which may indicate the existence of control is ownership interest. The holding of an ownership interest usually entitles the investor to an equivalent percentage interest in the voting rights of the investee. Consequently, a majority ownership interest would normally, though not necessarily, be accompanied by the existence of control. However, it is the voting rights rather than the ownership interest that provide the potential for control. In fact, it may be possible to control another entity without holding any ownership interest in that entity. This would be rare in the private sector where it is normal for an entity to have owners with an equity interest therein, especially where a third unrelated party holds a majority ownership interest. However, in the case of non-business entities in the public sector where the holding of an equity interest is frequently not possible, control without ownership will usually be the case.

24 In the public sector, a parent entity/subsidiary relationship could be established in the manner outlined in the preceding paragraphs or, as is more frequently the case, the existence of control might be specified by legislative or executive authority or by administrative arrangements where there is power to give policy directions. In determining whether the relationship between similar organisations within the public sector constitutes a control relationship, the following factors would be among those which should be

considered either singly or in combination: ministerial approval being required for operating budgets; the power of the Minister or a central authority to appoint and remove members of the board of management; or a ministerial power of direction. Where the relationship between a public hospital, for instance, and a central authority constitutes a control relationship, this Standard would require consolidated financial reports to be prepared for the economic entity comprising the central authority and the controlled hospital.

25 The concept of control is defined as a capacity, thereby allowing for the role of dominance to be a passive one rather than one which is necessarily actively exercised. If doubt exists as to whether an entity has the capacity to dominate another entity, there may, on occasions, need to be an active demonstration of control. This may be evident, for instance, by an entity being able to obtain financial information, internal management forecasts and budgets, and entity records from the other entity on request.

26 It may be possible to control the voting rights of another entity without holding a majority interest in the voting rights. This would happen where, in the absence of another entity dominating the composition of the board of directors, voting rights held by one entity, while less than 50 per cent, constitute a majority of those voting rights which are exercised.

27 The indicators of control outlined in the preceding paragraphs need to be distinguished from the circumstance where control of a particular entity is jointly held by two or more unrelated entities such that none unilaterally controls that entity. In this case none of the entities would qualify as the parent entity; however, it is important to consider the substance of the relationship between the entities which are deemed to have joint control of that other entity. For example, it is not unusual for an entity to be established to avoid recognising certain assets and liabilities in a financial report. While ownership interests and board representation of the new entity may be vested equally in the entity which sought to establish the new entity and in its financiers or legal advisors, this relationship may not constitute joint control as discussed above. To determine with whom control lies, it will be necessary to examine the manner in which major policy decisions are reached and the nature of the control over ongoing activities of the entity, rather than accepting that the nominal powers reflect the substance of the relationship.

28 The definition of "control" is such that, on rare occasions, an entity may appear to be the subsidiary of two unrelated entities. An example of this would occur where an entity exercises dominance of the decision-making in relation to the operating policies of

another entity while another entity simultaneously possesses the capacity to dominate decision-making without exercising that power. This form of control, while rare, may be evident where institutional investors hold investments with the objective of generating positive cash flows through dividends and capital gains rather than for the purpose of managing the operations of the other entity. It is important to establish that the entity actually exercising dominance over the operating policies is not merely doing so, either implicitly or explicitly, in accordance with the wishes of the other "controlling" entity. The concept of control employed in this Standard is defined in terms of dominance of both the financial and operating policy decisions, which implies a singular line of power. In the example cited in this paragraph, if neither of the entities is in the position of absolute dominance over the third entity, the relationship would be one of joint control determined by implicit agreement rather than control.

29 Sometimes an entity is regarded as being economically dependent on another entity. This is usually the case when the viability of the ongoing operations of one entity depends on funding by, or on a significant volume of business with, another entity. However, it ought not to be assumed that economic dependence is synonymous with control. While economic dependence would usually give rise to a relationship based on influence it is unlikely, in the absence of some very restrictive contractual condition, that it would enable an entity to dominate decision-making in relation to both the financial and operating policies of the other entity as would be necessary for control to exist.

30 The capacity of one entity to dominate decision-making, in relation to the financial and operating policies of another entity, is insufficient in itself to ensure the existence of control as defined in this Standard. The parent entity needs to be able to dominate decision-making so as to enable that other entity to operate with it as part of an economic entity in pursuing its objectives. This will have the effect of excluding from the definitions of "parent entity" and "subsidiary" relationships which do not extend beyond, for instance, that of a liquidator and the entity being liquidated and would normally exclude a lender and borrower relationship and a receivership relationship. Similarly, a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee would not be considered to control the trust for the purposes of this Standard.

31 Where control appears to be vested entirely with one party, another party might, in substance, be the controlling party. Consider, for example, a trust where the capacity for decision-making appears to rest entirely with the trustee, even to the extent that the trust deed precludes the unitholders from changing the trustee or holding

effective meetings. Because the trustee's capacity to dominate decision-making is governed by the trustee's fiduciary responsibility at law to act in the best interests of the beneficiaries of the trust, those beneficiaries indirectly have the capacity to dominate decision-making in respect of the net assets of the trust.

Defining the economic entity

COMMENTARY

32 In this Standard, consistent with the objective of reporting for related entities so as to reflect that they operate as a single economic entity, the criterion of control has been used to determine a parent entity/subsidiary relationship and for identifying an economic entity for which consolidated financial reports may be prepared. Under this approach, the economic entity is defined as the group of entities comprising the parent entity and each of the entities which it controls. The consolidated financial reports for the economic entity would reflect the performance of that group and the resources under the control of the parent entity irrespective of whether an ownership interest is held. This approach is considered to provide the most meaningful consolidated financial reports in that it enables a number of individual but related entities to be identified as a single entity for financial reporting purposes in a manner which is consistent with the substance of the economic entity operating as a single economic unit.

33 In the public sector the relationship between entities is established by control over policies and processes which is exercised under authority of legislation or administrative arrangements. This form of control is not normally accompanied by the existence of ownership interests. Consequently, the provision of relevant information in the public sector will necessitate the preparation of consolidated financial reports based on control and this is consistent with financial reporting in the private sector.

34 Where a member of the economic entity is structured in a form which differs from the legal form of other members of the economic entity or where the parent entity does not hold an ownership interest in an entity which, in all respects, is a member of the economic entity, these factors would not cause those entities to be excluded from consolidated financial reports for that economic entity. To prepare consolidated financial reports to reflect primarily the parent entity's ownership interests would unnecessarily restrict the financial information that can be made available to users. However, it is considered that disclosure in consolidated financial reports of information about ownership interests is of relevance to users of financial reports. Therefore, this

Standard requires that a consolidated financial report disclose the extent to which the equity of the economic entity is attributable to the ownership group of the parent entity and to the outside equity interest.

Identifying an economic entity in the public sector

COMMENTARY

35 This Standard does not attempt to identify all economic entities in the public sector which should prepare general purpose financial reports. Instead, it seeks to describe the factors which should be considered in determining whether an economic entity exists and whether that economic entity constitutes a reporting entity. In addition, the Standard identifies the accounting techniques which should be employed when, in the preparation of general purpose financial reports, the financial reports of a number of separate entities are to be combined. This approach avoids the prescriptive designation of artificial reporting entities and the resulting preparation of meaningless consolidated financial reports.

36 In the public sector, reporting entities may include ministerial portfolios, ministerial departments, statutory authorities or other entities. In some cases the reporting entity may be an economic entity, that is, it may comprise a parent entity and a number of controlled entities, and in other cases the reporting entity may be the parent entity or the controlled entity itself. For instance, whether or not a ministerial portfolio would be a reporting entity depends on whether the minister is able to deploy resources across all entities included in that portfolio and there exists users dependent on general purpose financial reports for information about the deployment and management of resources dedicated to that portfolio.

37 Whether one entity has the capacity to dominate decision-making in respect of both financial and operating policies of another entity will depend on the particular circumstances. While private schools, private hospitals, individual local governments and universities may be financially dependent, to a greater or lesser degree, on state or federal governments or agencies thereof, they would not be considered to be controlled by those governments or agencies for the purposes of this Standard. Therefore, this Standard does not require that such entities be consolidated with a government or government agency.

38 In determining the existence of an economic entity in the public sector the controlling entity's ability to deploy the resources under its control and whether there are restrictions on the allocation of

funds between activities under its authority need to be considered. In addition, the ability of the entities to operate together in pursuing the objectives of the controlling entity is a central characteristic of an economic entity. If the operation of these entities as one is precluded, for example through the existence of separate administrations, it is clear that the entities do not constitute a single economic entity. A minister may have responsibility for more than one function. Those functions may be encompassed in a single portfolio or administered through a number of portfolios. The specification of separate objectives for each function will usually be an indication of the existence of separate economic entities, regardless of whether the functions are combined in the one portfolio or administered separately through more than one portfolio. Similarly, the financial reports of individual local governments would not be aggregated for the purpose of preparing financial reports which consolidate all local governments in each State or Territory because the combination of such local government bodies would fail to satisfy the definition of an economic entity.

Preparation of Consolidated Financial Reports

STANDARDS

39 **Each parent entity required to apply this Standard shall prepare and present consolidated financial reports for the economic entity in which it is the parent entity.**

40 **The consolidated financial report shall be prepared by combining the financial report of each of the entities comprising the economic entity and this aggregated information shall be presented as one financial report. This aggregation shall be subject to such adjustments as may be necessary under this Standard.**

Use of consolidated financial reports

COMMENTARY

41 The provision of one financial report for the economic entity enhances the ability of those users of financial reports who have an interest in the existence of the economic entity to assess the performance, financial position, and financing and investing of the economic entity, rather than having to rely solely on individual financial reports. However, the preparation of consolidated financial reports does not, of itself, overcome the need to prepare individual financial reports for the entities within the economic entity. Consolidated financial reports are required in addition to

any such individual financial reports. The alternative presentation format for the economic entity, whereby the individual financial reports for some, or all, of the entities comprising the economic entity are presented without aggregation, is not permitted by this Standard. Consolidated financial reports are the only presentation format which satisfies the objective of reporting for the economic entity as a single reporting entity.

Consolidation adjustments

COMMENTARY

42 In combining the financial report of a parent entity and those of its subsidiaries, various adjustments may be necessary to reflect the performance, financial position and financing and investing of the economic entity as a single reporting entity. Principally these adjustments will be necessary whenever entities within an economic entity have had transactions with each other or where there is a change in the composition of the economic entity. Two distinct types of transactions can be identified. The first of these relates to the holding of investments by a parent entity in its subsidiaries and is discussed in paragraphs 57 to 62. The second covers all other transactions within the economic entity, examples of which would include interentity sales of inventory or other assets and interentity loans. The necessary consolidation adjustments for the effects of these transactions are outlined in paragraphs 64 to 66. The consolidation adjustments necessary where there is a change in the composition of the economic entity are covered in paragraphs 69 to 79.

Composition of Consolidated Financial Reports

STANDARDS

43 **The consolidated financial report shall comprise a consolidated profit and loss or other operating statement, a consolidated balance sheet or statement of financial position, a consolidated statement of cash flows, and notes thereto, subject to paragraph 50.**

44 **A parent entity shall include in the consolidated financial report, in an aggregated form and subject to such adjustments as may be necessary under this Standard, the information contained in the financial report of each of its subsidiaries as from the date on which the parent entity obtains control of each of the subsidiaries until such time as the parent entity ceases to control each of the subsidiaries.**

45 **The consolidated financial report shall be presented for the same reporting period for which the parent entity's financial report is presented and shall contain comparative amounts for the preceding corresponding reporting period.**

46 **The comparative amounts required under paragraph 45 shall not be adjusted for the effects of transactions which have taken place during the current reporting period, except in so far as reclassification would assist comparison, but shall, where practicable, reflect the results of the economic entity for the preceding corresponding reporting period and the financial position of the economic entity in existence as at the end of that reporting period.**

Reporting dates

COMMENTARY

47 The requirement to prepare and present the consolidated financial report for the same reporting period for which the parent entity's financial report is presented may necessitate the preparation of an interim financial report in respect of a subsidiary or such other appropriate adjustments as may be necessary to prepare the consolidated financial report as if the reporting dates were the same.

Accounting policies

STANDARDS

48 **The accounting policies employed in the preparation and presentation of the consolidated financial report shall be consistent.**

49 **Where the accounting policies adopted by entities within the economic entity are dissimilar and are not required by another Australian Accounting Standard, adjustments to achieve consistency shall be made in preparing the consolidated financial report.**

50 **Notwithstanding the requirements of paragraph 43, if in the public sector neither the cash basis of accounting nor accrual accounting is used consistently within an economic entity and it is not practicable to make adjustments to achieve consistency in preparing the consolidated financial report, the parent entity shall, to the extent practicable, present the information that would normally be contained in the consolidated financial report required under paragraph 43.**

COMMENTARY

51 Since the consolidated financial report provides financial information about an economic entity as a single reporting entity, consistent accounting policies need to be adopted in the preparation of the report. Where the accounting policies adopted by entities within the economic entity are dissimilar, adjustments need to be made in preparing the consolidated financial report to achieve consistency, unless the dissimilar policies were required by Australian Accounting Standards. An example of dissimilar policies required by Australian Accounting Standards is the differing measurement bases for investments pursuant to Australian Accounting Standard AAS 26 "Financial Reporting of General Insurance Activities". Examples of dissimilar accounting policies necessitating adjustment in preparing consolidated financial reports include the use by an overseas subsidiary of policies that are not permitted by Australian Accounting Standards, such as the net-of-tax method of tax-effect accounting or an inventory valuation method like last-in-first-out. However, where alternative accounting methods or treatments are currently available within an entity, for instance differing depreciation or inventory valuation methods, the use of both within an economic entity would necessitate an adjustment only where they were not applied on a consistent basis within like segments or for similar classes of assets and there was a material effect.

<u>*Parent Entity Holds an Ownership Interest in a Subsidiary*</u>

STANDARDS

52 **In preparing the consolidated financial report where the parent entity holds an ownership interest in a subsidiary, the investment in the subsidiary shall be eliminated in full together with the parent entity's corresponding entitlement to the subsidiary's equity as at the date of acquisition.**

53 **Where elimination of the investment in the subsidiary and the parent entity's corresponding entitlement to the subsidiary's equity gives rise to a difference on consolidation, such difference shall be accounted for in accordance with Australian Accounting Standards AAS 18 "Accounting for Goodwill" and AAS 21 "Accounting for the Acquisition of Assets (including Business Entities)".**

54 **Where the net assets of the subsidiary are revalued in the accounting records of the subsidiary to their fair values as at the date on which the parent entity acquired its investment, the resulting revaluation reserve shall, in the consolidated financial**

report, be attributed to the outside equity interest to the extent that it reflects increments or decrements in asset values that can be attributed to the outside equity interest.

55 **Where an adjustment is made on consolidation to revalue the net assets of the subsidiary to their fair values as at the date on which the parent entity acquired its investment and to recognise goodwill (if any), adjustments shall be made on consolidation:**

- **(a) to the depreciation and amortisation expenses recognised by the subsidiary in relation to assets subject to depreciation or amortisation, so as to reflect the expenses to the economic entity;**
- **(b) in eliminating the equity balances of the subsidiary in accordance with paragraph 52; and**
- **(c) to attribute the remaining revaluation reserve, if any, to the outside equity interest.**

56 **Where an asset is disposed of, the carrying amount of which has been adjusted on consolidation in accordance with paragraph 53, the resulting gain or loss to the subsidiary shall be adjusted on consolidation to reflect the gain or loss to the economic entity, with a corresponding adjustment on consolidation in eliminating the equity balances of the subsidiary in accordance with paragraph 52.**

COMMENTARY

57 While preparation of the consolidated financial report is a relatively straightforward aggregation process where the relationship between entities within the economic entity is limited to a control relationship and there are no transactions between the entities, consolidation adjustments are necessary where the parent entity holds an ownership interest in a subsidiary. In the private sector it is common for a parent entity to hold an ownership interest in a subsidiary since, typically, a parent entity's control of a subsidiary is derived from a majority voting interest in the subsidiary stemming from the holding of an ownership interest in that entity. In the public sector the existence of control may or may not be accompanied by the capacity to hold an ownership interest. Control also can be established by statute or regulation in that sector.

58 Where a parent entity holds an ownership interest in a subsidiary, the investment account reflected in the parent entity's financial report represents the cost of acquiring a share of the subsidiary's equity. Consequently, when combining the individual financial reports to prepare the consolidated financial report, a consolidation

adjustment will need to be made to eliminate the investment account together with the corresponding portion of the investee's equity balances as at the date of acquisition. Any difference arising from the adjustment would need to be accounted for on consolidation in accordance with Australian Accounting Standards AAS 18 "Accounting for Goodwill" and AAS 21 "Accounting for the Acquisition of Assets (including Business Entities)". This would mean that the net assets acquired would need to be recognised at fair value or, where applicable, at fair value less any discount on acquisition. This may necessitate adjustments to the carrying amounts of assets which are not normally revalued, for example, inventory.

59 Where the assets of the subsidiary are recognised at amounts which differ from their fair values as at the date of acquisition, there are two approaches to recognising the necessary adjustments. These are:

(a) to revalue the identifiable assets in the accounting records of the subsidiary; or

(b) to recognise the necessary adjustments on consolidation.

60 Under the first approach, all of the non-current assets of the subsidiary would be revalued to their fair values in the accounting records of the subsidiary in accordance with Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-current Assets". The portion of the resulting revaluation reserve which is not eliminated on consolidation as pre-acquisition equity would need to be attributed to the outside equity interest. Where an adjustment is necessary to write down the carrying amount of inventory this would need to be processed in the accounting records of the subsidiary in accordance with Australian Accounting Standard AAS 2 "Measurement and Presentation of Inventories in the Context of the Historical Cost System".

61 Under the second approach, in preparing the consolidated financial report, an adjustment would be processed to eliminate the investment and the corresponding equity in the subsidiary and to recognise any increments or decrements necessary to restate the carrying amounts of the identifiable net assets acquired to their fair values as at the date of acquisition. That portion of the identifiable non-current assets of the subsidiary attributed to any outside equity interest would also need to be revalued to fair values as at the date of acquisition. This would ensure that the subsidiary's assets recognised in the consolidated financial report are measured on a consistent basis as at the date of acquisition. The resulting revaluation reserve would need to be attributed to the outside equity interest.

62 Where an adjustment is made on consolidation to revalue the net assets of the subsidiary on the basis of their fair values at acquisition and these assets are subject to depreciation or amortisation, an adjustment will also need to be made on consolidation to ensure that the depreciation and amortisation expenses reflect the revisions in the carrying amounts and thereby correctly reflect the depreciation and amortisation expenses to the economic entity. Since the cost incurred by the parent entity when acquiring the assets of the subsidiary reflects the profit-making potential of the assets, the component of retained profits (surplus) or accumulated losses (deficiency) which is pre-acquisition in nature will be increased or decreased as the assets acquired are used and as depreciation or amortisation expense is recognised. Therefore, to the extent of the parent entity's ownership interest in the subsidiary, the consolidation adjustments to depreciation and amortisation affect the equities of the subsidiary which are in the nature of pre-acquisition equities and an appropriate adjustment would need to be made on consolidation in eliminating these equities. Similarly, where an asset is disposed of, the carrying amount of which has been adjusted on consolidation, the resulting gain or loss to the subsidiary would need to be redetermined from the viewpoint of the economic entity and, on consolidation, adjusted accordingly. This adjustment would constitute the realisation of pre-acquisition equities and an adjustment would need to be made on consolidation in eliminating pre-acquisition equities. These adjustments are illustrated in Appendix 1 of this Standard.

Transactions within the Economic Entity

STANDARDS

63 **In preparing the consolidated financial report, the effects of all transactions between entities within the economic entity shall be eliminated in full.**

COMMENTARY

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

65 To the extent that a balance is outstanding at the end of the current reporting period and has resulted from a transaction within the economic entity in a previous reporting period, such balances would need to be eliminated in preparing the consolidated financial report. This would include, for example, loans between a parent entity and a subsidiary and the transfer within the economic entity of an asset which remains on hand at the end of the current reporting period at an amount different from the original cost to the economic entity. Where such a transaction gives rise to a profit or loss which at the reporting date remains unrealised with respect to a party external to the economic entity, the unrealised profit or loss would need to be eliminated. The profit or loss would become realised when the asset on which the profit or loss accrued is sold to a party external to the economic entity or as the future benefits embodied in the asset are consumed by the economic entity.

66 Adjustments may need to be made for the tax-effect of transactions eliminated in preparing the consolidated financial report. Profits and losses which are unrealised with respect to the economic entity may be realised in the accounting records of the entity making the sale and therefore may be subject to income tax. Since the income tax relates to results which will not be reported in consolidated financial reports until subsequent reporting periods, the relevant tax expense needs to be determined and accounted for in the consolidated financial report in accordance with Australian Accounting Standard AAS 3 "Accounting for Income Tax (Tax-effect Accounting)".

<u>*Reciprocal Ownership Interests within the Economic Entity*</u>

STANDARDS

67 **In preparing the consolidated financial report, where two entities within the economic entity each hold an ownership interest in one another, the amounts of the interentity investments shall be eliminated.**

68 **In the circumstances set out in paragraph 67, in allocating the equity of the economic entity between the ownership group of the parent entity and the outside equity interest, the respective percentage ownership interests shall be determined after negating the effect of the interrelationship between the entities within the economic entity.**

<u>*Loss of Control of a Subsidiary*</u>

STANDARDS

69 **Subject to paragraph 70, where a parent entity ceases to control a subsidiary, information relating to that subsidiary shall, as from the date when control ceases, be excluded from any consolidated financial report prepared by that parent entity.**

70 **Where a parent entity's loss of control of a subsidiary occurs during a reporting period, the consolidated profit and loss or other operating statement shall include the results of the subsidiary for that part of the reporting period during which the parent entity had control of the subsidiary.**

COMMENTARY

71 A parent entity may cease to control a subsidiary without selling an ownership interest in the subsidiary. Where such a loss of control occurs, that former subsidiary would need to be excluded, as from the date when control ceases, from any consolidated financial report prepared by the parent entity. This would necessitate including in the consolidated profit and loss or other operating statement the results of the subsidiary for only that part of the current reporting period during which the parent entity had control of the subsidiary. In presenting the appropriation of profits in the consolidated profit and loss or other operating statement, the opening balance of retained profits (surplus) or accumulated losses (deficiency) will need to be consistent with the closing balance for the previous reporting period. To achieve this, it will be necessary to make an adjustment on consolidation to include the retained profits (surplus) or accumulated losses (deficiency) of the former subsidiary

recognised during those previous reporting periods during which it was a subsidiary of the parent entity. A similar adjustment will be necessary in relation to post-acquisition movements in reserves of the former subsidiary. The subsidiary would then be deconsolidated by the economic entity recognising an expense or revenue for the current reporting period to reflect the loss or gain to the economic entity as a result of the parent entity's loss of control of the equity of that entity. This consolidation adjustment is illustrated in Appendix 2 of this Standard.

Sale of an Ownership Interest in a Subsidiary

STANDARDS

72 **Where an entity sells some or all of the ownership interest in another entity within the economic entity and the parent entity thereby loses control of that subsidiary, the gain or loss recognised on the sale shall, in preparing the consolidated financial report, be adjusted by the net post-acquisition movement to the date of sale in the retained profits (surplus) or accumulated losses (deficiency) and reserves of the subsidiary.**

COMMENTARY

73 When entities within the economic entity sell some or all of the ownership interest in a subsidiary and the parent entity thereby loses control of that subsidiary, the gain or loss recognised on the sale will need to be adjusted when preparing the consolidated financial report so as to reflect the gain or loss to the economic entity. The gain or loss to the economic entity is the amount by which the economic entity is better or worse off as a result of the sale of the ownership interest and would be determined as the difference between the proceeds of sale and the initial cost of that portion of the ownership interest sold adjusted for post-acquisition movements in any equities in relation to which the parent entity loses control upon sale of the ownership interest. Appendix 2 illustrates this consolidation adjustment.

STANDARDS

74 **Where an entity sells some or all of the ownership interest in another entity within the economic entity and the parent entity retains control of that subsidiary, the gain or loss recognised on the sale shall, in preparing the consolidated financial report, be adjusted by the net pre-acquisition retained profits (surplus) or accumulated losses (deficiency) and reserves of the subsidiary relating to the portion of the ownership interest sold.**

COMMENTARY

75 Where some or all of the ownership interest in a subsidiary is sold but the parent entity retains control, the subsidiary would continue to be part of the economic entity and the financial report of the subsidiary would continue to be included in the consolidated financial report. The gain or loss recognised on the sale would be carried forward on consolidation rather than being eliminated, because the parent entity's retention of control of the subsidiary means that the information contained in the financial report of the subsidiary will continue to be included in the consolidated financial report. In addition, there will be an increase or decrease in the operating profit of the economic entity arising from pre-acquisition profits or losses and reserves which previously were eliminated on consolidation now being attributable to the outside equity interest. This will result in a total increase in the assets of the economic entity equal to the amount of the sale proceeds. In disclosing the operating profit and equity amounts attributable to the parent entity and to the outside equity interest, the consolidated financial report would need to reflect the proportionate decrease in the equity of the subsidiary held by the parent entity and the corresponding increase in the amount attributed to the outside equity interest. This consolidation adjustment is illustrated in Appendix 2 of this Standard.

Acquisition of an Additional Ownership Interest in a Subsidiary

STANDARDS

76 **Where a parent entity increases its ownership interest in a subsidiary through the acquisition of additional capital of the subsidiary, the acquisition shall, as at the date of acquisition, be accounted for separately from previous acquisitions of ownership interests in the subsidiary and, in preparing the consolidated financial report, the standards set out in paragraphs 52 to 56 shall be applied in respect of the amount of the additional investment.**

COMMENTARY

77 Where a parent entity increases its ownership interest in a subsidiary through the acquisition of additional capital of the subsidiary, the acquisition is accounted for separately from previous acquisitions relating to the subsidiary. The necessary consolidation adjustments, including separate determination and recognition of the fair values of the net assets of the subsidiary and any goodwill/discount arising on the acquisition, would need to be made in accordance with the principles contained in paragraphs 57

to 62. However, any resulting revaluation reserve which is not eliminated on consolidation as pre-acquisition equity would need to be attributed to the outside equity interest, except to the extent that it relates to the holding by the parent entity of an ownership interest in the subsidiary which was acquired prior to the above-mentioned acquisition.

New Issue of Capital by a Subsidiary

STANDARDS

78 **Where a subsidiary makes a new issue of capital, the share of retained profits (surplus) or accumulated losses (deficiency) and reserves attributed to the parent entity and to the outside equity interest shall reflect the parent entity's ownership interest after the issue of the capital.**

COMMENTARY

79 Where a subsidiary makes a new issue of capital, the only effect on the consolidated financial report will be an increase in the equity of the economic entity, to the extent that the issue of capital was subscribed by outside equity interests, and a corresponding increase in cash or other assets. The economic entity will not experience any movement in its retained profits (surplus) or accumulated losses (deficiency) as a result of the capital issue. However, the parent entity may make a gain or loss by not maintaining its proportionate ownership interest in the subsidiary, and an equivalent loss or gain would be borne by the outside equity interest. In determining such gains and losses, the respective shares of the capital, retained profits (surplus) or accumulated losses (deficiency), and reserves of the economic entity that can be attributed to the parent entity and to the outside equity interest would need to be considered before and after the new issue of capital.

Outside Equity Interest

STANDARDS

80 **Where there exists an outside equity interest in the economic entity, it shall be described as such and disclosed as an equity item in the consolidated balance sheet or statement of financial position, disclosing separately the capital, retained profits (surplus) or accumulated losses (deficiency) and reserves comprising that amount.**

81 **Outside equity interest shall be determined as the aggregate of the equity of subsidiaries, other than that held either directly or indirectly by the ownership group of the parent entity, after making adjustments for unrealised profits and losses of subsidiaries and such other adjustments as may be necessary to comply with the standards set out in this Standard.**

82 **Where there exists an outside equity interest there shall be disclosed separately that portion of the operating result/profit or loss and extraordinary items after income tax of the economic entity for the reporting period which can be attributed to outside equity interests.**

COMMENTARY

83 Under the strict application of the entity concept of consolidation, the consolidated balance sheet or statement of financial position would reflect the aggregate equity components of the economic entity without regard to the identity of the ownership group of the economic entity. However, it is considered relevant to disclose the amount of equity attributable to the parent entity ownership group and to the outside equity interest, disclosing separately the capital, retained profits (surplus) or accumulated losses (deficiency) and reserves comprising each amount. This information will enable the users of the consolidated financial report to determine the aggregate capital, retained profits (surplus) or accumulated losses (deficiency) and reserves of the economic entity.

84 The amount disclosed as being attributable to the outside equity interest would need to be determined as the aggregate of the respective proportionate shares in the equity of subsidiaries, after making adjustments for unrealised profits and unrealised losses of subsidiaries and such other adjustments as may be necessary to comply with the standards set out in this Standard. Where the outside equity interest is a negative amount it would be disclosed as an equity item of the outside equity interest, except to the extent that the parent entity agrees to bear the responsibility for outgoings resulting from the accumulated losses (deficiency), in which case the item would be allocated to the parent entity ownership group.

Consolidated Profit and Loss or other Operating Statement

STANDARDS

85 **The consolidated profit and loss or other operating statement shall disclose the results of the economic entity for the reporting period and shall be prepared in accordance with Australian Accounting Standard AAS 1 "Profit and Loss or other Operating Statements".**

Consolidated Balance Sheet or Statement of Financial Position

STANDARDS

86 **The consolidated balance sheet or statement of financial position shall disclose the assets, liabilities and equities of the economic entity, as at the reporting date.**

Consolidated Statement of Cash Flows

STANDARDS

87 **The consolidated statement of cash flows shall disclose the cash flows of the economic entity for the reporting period and shall be prepared on the basis set out in Australian Accounting Standard AAS 28 "Statement of Cash Flows".**

88 **In preparing a consolidated statement of cash flows, amounts included in respect of the economic entity, especially in relation to subsidiaries entering or leaving the economic entity, shall be determined in accordance with the standards set out in this Standard.**

Additional Disclosures

STANDARDS

89 **The consolidated financial report shall disclose, by way of note:**

(a) **the identity of the parent entity within the economic entity and, if this economic entity is part of one or more larger economic entities, the identity of the ultimate parent entity in Australia and, if different, the identity of the ultimate parent entity;**

(b) **the identity and, where applicable, country of incorporation of each subsidiary within the economic entity, indicating those which have become part of the economic entity during the reporting period;**

(c) **the identity of any entity which has ceased to be part of the economic entity during the reporting period, the ownership interest, if any, which the parent entity retains in that entity and the aggregate gain or loss for the economic entity arising from those cessations;**

(d) **the identity of any subsidiary in which the parent entity holds an ownership interest and/or voting rights of 50 per cent or less, together with an explanation of how control exists;**

(e) **the identity of any entity in which the parent entity holds an ownership interest of more than 50 per cent but which is not a subsidiary of that parent entity, together with an explanation of why control does not exist; and**

(f) **the respective gain or loss, if any, made by the parent entity and the outside equity interest on new issues of capital by subsidiaries.**

Transitional Provisions

STANDARDS

90 **Where the accounting policies required by this Standard are not already being applied as at the beginning of the reporting period to which this Standard is first applied, they shall be applied as at that date. Subject to paragraphs 91 to 93, where this gives rise to initial adjustments, the net amount of those adjustments shall, in accordance with Australian Accounting Standard AAS 1 "Profit and Loss or other Operating Statements", be adjusted against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.**

91 **Where the application of this Standard as at the beginning of the reporting period to which this Standard is first applied causes the composition of the economic entity previously reflected in the consolidated financial report (whether or not presented as one financial report) to change so as to include or exclude an entity or entities:**

(a) the identity of that entity or those entities shall be disclosed;

(b) the aggregate increases in assets, liabilities and equities of the economic entity caused by the inclusion or exclusion of entities shall be separately disclosed as at the beginning of that reporting period;

(c) the aggregate decreases in assets, liabilities and equities of the economic entity caused by the inclusion or exclusion of entities shall be separately disclosed as at the beginning of that reporting period; and

(d) the standards set out in paragraphs 53 to 56 of this Standard shall be complied with to the extent practicable in relation to such included or excluded entities, and any resulting revenue or expense shall be adjusted against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of that reporting period.

92 **Where retrospective application of the standards set out in paragraphs 53 to 56 of this Standard is not practicable, the amounts attributed to the net assets of the subsidiary and any goodwill on consolidation thereof shall be deemed to have been determined in accordance with this Standard.**

93 **Where:**

(a) the application of this Standard as at the beginning of the reporting period to which this Standard is first applied does not cause the composition of the economic entity previously reflected in the consolidated financial report to change so as to include or exclude an entity or entities;

(b) a consolidated financial report (presented as one financial report) was not prepared in accordance with the standards set out in this Standard for the preceding corresponding reporting period; and

(c) the comparative amounts for the preceding corresponding reporting period have not been adjusted to reflect the results of the economic entity for that reporting period and the financial position of the economic entity in existence as at the end of that reporting period;

the aggregate assets, liabilities and equities of the economic entity in existence as at the beginning of the reporting period to which this Standard is first applied shall be separately disclosed in the consolidated financial report for the reporting period.

COMMENTARY

94 When paragraph 93 applies, the consolidated financial report for the reporting period to which this Standard is first applied needs to disclose the nominated aggregate comparative amounts determined as if this Standard had been applied to those amounts. Paragraph 93 does not apply when, for example, the comparative amounts are adjusted in accordance with paragraph 46.

COMPATIBILITY WITH INTERNATIONAL ACCOUNTING STANDARD IAS 27

The accounting standards set out in this Standard are generally consistent with those set out in IAS 27 "Consolidated Financial Statements and Accounting for Investments in Subsidiaries". IAS 27 is applicable to all parent entities other than those which are wholly-owned subsidiaries, or virtually wholly-owned subsidiaries with the approval of the owners of the minority interest. Further, IAS 27 requires parent entity/subsidiary relationships to be excluded from the consolidated financial statements where control is intended to be temporary. Otherwise, compliance with this Australian Accounting Standard ensures compliance with IAS 27.

APPENDIX 1

REALISATION OF PRE-ACQUISITION EQUITIES ARISING FROM DISPOSAL OR USE OF ASSETS REVALUED ON CONSOLIDATION

This Appendix forms part of the commentary and is provided for illustrative purposes only. The examples in this Appendix illustrate the accounting treatment outlined in paragraph 62 of this Standard concerning the realisation of pre-acquisition equities arising from the disposal or use of assets which are revalued on consolidation.

Disposal of Non-depreciable Assets

Example: The parent entity acquires all of the shares of another entity for $120,000, thereby gaining control of that entity. As at the date of acquisition the subsidiary had share capital of $80,000, retained profits of $10,000 and other reserves of $20,000. The subsidiary held land which, at the date of acquisition, had a fair value of $26,000, being an excess of $10,000 over its carrying amount of $16,000.

Where the asset is revalued on consolidation, the following journal entry would need to be made on consolidation to record the elimination of the investment and the pre-acquisition equities of the subsidiary:

	DR $	CR $
Share Capital	80,000	
Retained Profits (Opening Balance)	10,000	
Other Reserves	20,000	
Land	10,000	
Shares in Subsidiary		120,000

Assume that two years after acquisition the subsidiary sells the land for $42,000 and recognises a gain of $26,000 in its accounting records. In preparing the consolidated financial report, the above journal entry would need to be amended to reflect that the land is no longer held and that, of the $26,000 gain on sale recognised in the current reporting period, the gain on sale to the economic entity is only $16,000. This is because the fair value of the land at acquisition was $10,000 in excess of the carrying amount and this was reflected in the purchase consideration. Hence, the sale of the land at a gain has caused the component of retained profits which is in the nature of pre-acquisition profits to be increased. On consolidation the following journal entry to eliminate pre-acquisition equities would be necessary in the reporting period in which the land is sold:

	DR	CR
	$	$
	80,000	
Share Capital		
Retained Profits		
(Opening Balance)	10,000	
Other Reserves	20,000	
Gain on Sale of Land	10,000	
Shares in Subsidiary		120,000

In subsequent reporting periods the following journal entry on consolidation would be necessary, assuming no other adjustments:

	DR	CR
	$	$
Share Capital	80,000	
Retained Profits		
(Opening Balance)	20,000	
Other Reserves	20,000	
Shares in Subsidiary		120,000

Use of Depreciable Assets

The above example shall now be varied to illustrate the effect on pre-acquisition equities where the subsidiary's asset which is revalued on consolidation is a depreciable asset.

Example: Assume the same as for the previous example except that rather than land being held, the subsidiary has plant and machinery which is carried at $16,000 but has a fair value at the date of acquisition of $26,000. This asset is considered to have a depreciable life of ten years as from the date of acquisition.

A portion of the profit generated through the economic entity's use of the asset is pre-acquisition profit in that, on acquisition, the parent entity recognised the profit-making potential of the asset by paying more for it than the carrying amount in the subsidiary's accounting records. Hence, as the asset is being used and depreciation expense recognised, the component of retained profits which is in the nature of pre-acquisition profits is increased. At the end of the first year after acquisition, the following journal entry on consolidation would be necessary to reflect this:

	DR $	CR $
Share Capital	80,000	
Retained Profits (Opening Balance)	10,000	
Other Reserves	20,000	
Plant & Machinery	10,000	
Depreciation	1,000	
Accumulated Depreciation		1,000
Shares in Subsidiary		120,000

In the next reporting period the following journal entry on consolidation would be necessary, assuming no other adjustments:

	DR $	CR $
Share Capital	80,000	
Retained Profits (Opening Balance)	11,000	
Other Reserves	20,000	
Plant & Machinery	10,000	
Depreciation	1,000	
Accumulated Depreciation		2,000
Shares in Subsidiary		120,000

APPENDIX 2

LOSS OF CONTROL OF A SUBSIDIARY
AND/OR SALE OF AN OWNERSHIP INTEREST IN A SUBSIDIARY

This Appendix forms part of the commentary and is provided for illustrative purposes only. The examples in this Appendix illustrate the accounting treatment outlined in paragraphs 71, 73 and 75 of this Standard concerning the accounting treatment in the consolidated financial report of a loss of control of a subsidiary and a sale of an ownership interest in a subsidiary.

Loss of Control

Paragraph 71 deals with the accounting treatment necessary on consolidation where a parent entity loses control of a subsidiary without selling an ownership interest in the subsidiary, that former subsidiary thereafter being excluded from the consolidated financial reports of the parent entity.

Example: The parent entity obtains control of a subsidiary on 1 January 19X1 and loses control on 30 June 19X2. During the reporting period ended 31 December 19X1 the subsidiary contributed $100,000 to the retained profits of the economic entity and a further $30,000 for the six months ended 30 June 19X2. During 19X1 the subsidiary revalued certain classes of non-current assets, with a revaluation increment of $20,000 recognised in reserves.

In preparing the consolidated financial report for the reporting period ended 31 December 19X2, the following journal entry would be necessary on consolidation. This entry would reinstate the opening balance of the retained profits and reserves of the economic entity so as to include the retained profits and movements in reserves of the former subsidiary recognised during those previous reporting periods during which it was a subsidiary of the parent entity and would recognise the results of the entity for the six-month period ended 30 June 19X2 during which it was a subsidiary of the parent entity, with a corresponding adjustment against the profits of the economic entity to reflect the parent entity's loss of control of the equity of the former subsidiary:

	DR $	CR $
Operating Profit (Loss of Subsidiary)	150,000	
Retained Profits (Opening Balance)		100,000
Asset Revaluation Reserve (Opening Balance)		20,000
Operating Profit		30,000

Sale of All of the Ownership Interest and Loss of Control

Paragraph 73 deals with the determination of the gain or loss to the economic entity when the parent entity sells some or all of its ownership interest in a subsidiary and in so doing loses control of that entity.

Example: The parent entity acquired a 100% ownership interest in a subsidiary on 1 January 19X1 for $100,000. On 30 June 19X3 the parent entity sold its ownership interest in the subsidiary for $300,000, and simultaneously lost control. During 19X1 and 19X2 the subsidiary contributed $140,000 to the retained profits of the economic entity. The operating profit of the subsidiary for the six months ended 30 June 19X3 was $40,000.

In preparing the consolidated financial report for the reporting period ended 31 December 19X3, the gain on sale of $200,000 recognised by the parent entity would need to be adjusted to reflect the gain or loss to the economic entity on sale of the ownership interest. The gain or loss to the economic entity would be determined as the difference between the sale price of $300,000 and the original cost of $100,000 increased by $180,000, being the profits of the subsidiary recognised since the parent entity acquired its ownership interest. Hence, the gain to the economic entity on the sale of the subsidiary would be $20,000. The following journal entry would be necessary on consolidation:

	DR $	CR $
Gain on Sale	180,000	
Retained Profits (Opening Balance)		140,000
Operating Profit		40,000

Sale of Part of the Ownership Interest and Loss of Control

The above example, in which it was assumed that the sale of the parent entity's total ownership interest in a subsidiary and the loss of control were simultaneous, shall now be varied to illustrate the accounting treatment where some, but not all, of the ownership interest is sold and control is lost simultaneously.

Example: The parent entity acquired a 100% ownership interest in a subsidiary on 1 January 19X1 for $100,000. On 30 June 19X3 the parent entity sold 80% of its ownership interest in the subsidiary for $240,000, and simultaneously lost control. During 19X1 and 19X2 the subsidiary contributed $140,000 to the retained profits of the economic entity. The operating profit of the subsidiary for the six months ended 30 June 19X3 was $40,000.

In preparing the consolidated financial report for the reporting period ended 31 December 19X3, the gain on sale of $160,000 recognised by the parent entity (being the sale price of $240,000 less the carrying amount of $80,000) would need to be adjusted to reflect the gain or loss to the economic entity on sale of the ownership interest since control of the subsidiary has been lost. The gain or loss to the economic entity would be determined as the difference between the sale price ($240,000) and the sum of the original cost of the ownership interest sold ($80,000) and the post-acquisition profits contributed to the economic entity by that 80% ownership interest in the subsidiary ($144,000). This results in a gain to the economic entity of $16,000 ($240,000 less $224,000), thus necessitating a reduction of $144,000 in the parent entity's recognised gain of $160,000.

Upon the parent entity's loss of control, the consolidated financial report could not include aggregation of the financial report of the former subsidiary. However, since that entity was part of the economic entity for part of the current reporting period the opening balance of retained profits, as derived from aggregating the financial reports of the entities comprising the economic entity at the reporting date, will need to be increased to reflect the former subsidiary's opening balance, that is, $140,000. (Note that it will be $140,000 and not 80% of this amount, since these are the profits that were able to be included in the consolidated financial report when the entity was part of the economic entity.) Similarly, the economic entity will need to reflect all of the profits of the subsidiary for the period to the loss of control of the subsidiary. Furthermore, because the consolidated financial report is compiled on the basis of control rather than ownership interest, all of the profits of the subsidiary must then be excluded from consolidation when the parent entity loses control. Therefore, the remaining $36,000 profits contributed by the subsidiary which have not been adjusted against the gain on sale will need to be deconsolidated. The following journal entry would be necessary in preparing the consolidated financial report:

	DR	CR
	$	$
Gain on Sale	144,000	
Operating Profit		
(Loss of Subsidiary)	36,000	
Retained Profits		
(Opening Balance)		140,000
Operating Profit		40,000

Sale of Part of the Ownership Interest and Retention of Control

The following example illustrates the accounting treatment necessary on consolidation where a parent entity sells some or all of its ownership interest in a subsidiary but retains control of that subsidiary. Discussion of this is contained in paragraph 75 of the Standard.

Example: The parent entity acquired a 100% ownership interest in a subsidiary on 1 January 19X3 for $100,000, at which date the subsidiary's equity consisted of share capital of $80,000 and retained profits of $20,000. On 31 December 19X4 the parent entity sold 25% of its ownership interest in the subsidiary for $35,000. The parent entity retained control of the subsidiary after the sale. During 19X3 the parent entity and the subsidiary recognised profits of $15,000 and $40,000 respectively.

Assume that the balance sheets or statements of financial position of the parent entity and the subsidiary are as follows:

Parent Entity Balance Sheet or Statement of Financial Position
as at 31 December 19X3

		$		$
Share Capital		90,000	Cash	90,000
Retained Profits				
(Opening Bal)	85,000		Shares in	
Operating Profit	15,000	100,000	Subsidiary	100,000
		190,000		190,000

Subsidiary Balance Sheet or Statement of Financial Position
as at 31 December 19X3

		$		$
Share Capital		80,000	Cash	70,000
Retained Profits				
(Opening Bal)	20,000			
Operating Profit	40,000	60,000	Other Assets	70,000

140,000	140,000

In preparing the consolidated financial report for the reporting period ended 31 December 19X3, the following journal entry would be necessary to eliminate the investment held by the parent entity at 31 December 19X3 and the corresponding pre-acquisition equity of the subsidiary:

	DR	CR
	$	$
Share Capital	80,000	
Retained Profits		
(Opening Balance)	20,000	
Shares in Subsidiary		100,000

This would give rise to the following consolidated balance sheet or statement of financial position:

Consolidated Balance Sheet or Statement of Financial Position
as at 31 December 19X3

		$		$
Share Capital		90,000	Cash	160,000
Retained Profits				
(Opening Bal)	85,000			
Operating Profit	55,000	140,000	Other Assets	70,000
		230,000		230,000

Assume that during 19X4 the parent entity and subsidiary both recognised profits of $15,000. The parent entity's profit includes a gain of $10,000 on the sale of a 25% ownership interest in the subsidiary for $35,000. The balance sheets or statements of financial position of the parent entity and subsidiary would be as follows:

Parent Entity Balance Sheet or Statement of Financial Position
as at 31 December 19X4

		$		$
Share Capital		90,000	Cash	130,000
Retained Profits				
(Opening Bal)	100,000		Shares in	
Operating Profit	15,000	115,000	Subsidiary	75,000
		205,000		205,000

Subsidiary Balance Sheet or Statement of Financial Position
as at 31 December 19X4

		$		$
Share Capital		80,000	Cash	85,000
Retained Profits				
(Opening Bal)	60,000			
Operating Profit	15,000	75,000	Other Assets	70,000
		155,000		155,000

In preparing the consolidated financial report for the reporting period ended 31 December 19X4, the following journal entry would be necessary to eliminate the investment held by the parent entity at 31 December 19X4 and the corresponding pre-acquisition equity of the subsidiary:

	DR	CR
	$	$
Share Capital	60,000	
Retained Profits		
(Opening Balance)	20,000	
Operating Profit		
(Gain to economic entity)		5,000
Shares in Subsidiary		75,000

The debit of $20,000 restates the opening balance of the consolidated retained profits to the amount recognised in the consolidated balance sheet at the end of 19X3. The $20,000 represents the retained profits of the subsidiary as at 1 January 19X3, the date of acquisition of the ownership interest by the parent entity.

The credit of $5,000 represents 25% of the $20,000 pre-acquisition retained profits which are now attributable to the outside equity interest and no longer eliminated on consolidation. The credit entry thus represents a gain to the economic entity arising from the sale of the ownership interest by the parent entity, and does not relate to either the gain/loss for the ownership group of the parent entity pursuant to the sale or the parent entity's reported profit.

In future reporting periods, the debit to retained profits and the credit to operating profit would be combined because the $5,000 credit will be included in the closing balance of consolidated retained profits for the reporting period in which the ownership interest is sold.

Note that only $75,000 of the subsidiary's pre-acquisition equity has been eliminated by the journal entry, compared with $100,000 at the end of the previous reporting period. This is because $25,000 of the subsidiary's pre-acquisition equity has now been acquired by the outside equity interest, thus resulting in a $25,000 increase in the equity of the economic entity. This $25,000 comprises $20,000 capital of the subsidiary and the $5,000 relating to pre-acquisition profits of the subsidiary (25% of $20,000), which previously were eliminated on consolidation.

The equity attributable to the outside equity interest at the end of 19X4 is determined as follows:

Outside Equity Interest		
		$
Share Capital	[25% of $80,000]	20,000
Retained Profits (Opening Balance)		-
Operating Profit	[25% of $75,000]	18,750
Total Equity		38,750

The outside equity interest did not exist at the beginning of 19X4 and thus has no entitlement to any part of the opening retained profits of the economic entity. The outside equity interest in the operating profit of the economic entity comprises $13,750 relating to post-acquisition profits of the subsidiary to which the outside equity interest is now entitled (being 25% of $55,000) and the $5,000 relating to pre-acquisition profits of the subsidiary (25% of $20,000) which are no longer eliminated on consolidation.

The interest of the ownership group of the parent entity in the operating profit of the economic entity for 19X4 is determined as follows:

Parent Entity Interest	
	$
Parent entity's reported 19X4 profit (100% interest)	15,000
plus Subsidiary's reported 19X4 profit (100% interest)	15,000
	30,000
less Post-acquisition profits sold (25% of $55,000)	(13,750)
	16,250

The consolidated balance sheet or statement of financial position could be presented as follows:

Consolidated Balance Sheet or Statement of Financial Position
as at 31 December 19X4

	Parent Entity Interest	Outside Equity Interest	Economic Entity
	$	$	$
Share Capital	90,000	20,000	110,000
Retained Profits (Opening Balance)	140,000	-	140,000
Operating Profit	16,250	18,750	35,000
Total Equity	246,250	38,750	285,000
Cash			215,000
Other Assets			70,000
Total Assets			285,000

The consolidated operating profit of $35,000 recognised for 19X4 may be reconciled as:

	$
Parent entity's reported 19X4 profit (includes $10,000 profit on sale of 25% ownership interest in subsidiary)	15,000
Subsidiary's reported 19X4 profit	15,000
Gain to economic entity per journal entry	5,000
Consolidated operating profit for 19X4	35,000

Thus the consolidated operating profit includes a total profit of $15,000 relating to the sale by the parent entity of the 25% ownership interest in the subsidiary: $10,000 through the parent entity's reported profit and the $5,000 gain to the economic entity through the journal entry. This total profit of $15,000 equals the difference between the sale proceeds of $35,000 and the $20,000 increase in the capital of the economic entity, and is reconciled between the parent entity and outside equity interests as follows:

Parent Entity Interest

	$
Profit on sale recognised by parent entity	10,000
less Post-acquisition profits sold (25% of $55,000)	(13,750)
Loss to parent entity ownership group	(3,750)

Outside Equity Interest

Post-acquisition profits acquired (25% of $55,000)	13,750
Gain re pre-acquisition retained profits	5,000
Gain ascribed to outside equity interest	18,750

Total gain to economic entity	15,000

In determining the gain or loss of the outside equity interest from the perspective of the economic entity, the $35,000 acquisition cost incurred by the outside equity interest is not taken into account as it is not a cost incurred by the economic entity.

APPENDIX 3

EXTRACTS FROM EXAMPLE CONSOLIDATED BALANCE SHEET OR STATEMENT OF FINANCIAL POSITION AND EXAMPLE CONSOLIDATED PROFIT AND LOSS OR OTHER OPERATING STATEMENT

This Appendix forms part of the commentary and is provided for illustrative purposes only. The example is designed to illustrate the requirements of this Standard as they would apply to a business entity and does not necessarily satisfy the disclosure requirements of other Australian Accounting Standards.

Extract from Consolidated Balance Sheet or Statement of Financial Position as at 30 June 19X9

	$'000	$'000
OWNERS' EQUITY		
Parent Entity Interest		
Share Capital	2,000	
Reserves	1,000	
Retained Profits	520	3,520
Outside Equity Interest		
Share Capital	400	
Reserves	200	
Retained Profits	120	720
		4,240

Extract from Consolidated Profit and Loss or other Operating Statement for the period ending 30 June 19X9

	Economic Entity
	$'000
Operating profit (surplus) before income tax [Note 1]	360
Income tax expense attributable to operating profit (surplus)	140
Operating profit (surplus) after income tax	220

	Parent Entity Interest	Outside Equity Interest

	$'000	$'000
Operating profit (surplus) after income tax	180	40
Retained profits (surplus) at 1 July 19X8	320	80
Transfer from Asset Revaluation Reserve	100	..20
Total available for appropriation	600	140
Dividends provided for or paid to:		
Parent entity shareholders	80	
Outside equity interest	…..	..20
Retained profits (surplus) at 30 June 19X9	520	120

Note 1

	Parent Entity Interest $'000	Outside Equity Interest $'000	Economic Entity $'000
Operating profit (surplus) before income tax has been determined after inclusion of the following items:			
Profit (loss) on a new issue of shares by a subsidiary	(9)	9	-