Consolidated Financial Statement – IFRS 10

Objective and Scope

Objective

To establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities

IFRS 10

- Requires the parent entity to consolidate the financial statement of all of its controlled subsidiaries
- Defines and establishes the principle of Control in much detail
- Sets out how to apply the principle of control for identifying control of investor over investee
- Sets out accounting requirement for the preparation of consolidated financial statement
- Does not deal with accounting requirement of IFRS 3

Objective and Scope (Cont.)

IFRS 10 applies to all reporting that prepares IFRS financial statements, except post employee benefit plans or other Long term employee benefit plans to which IAS 19 applies

Every Reporting Entity is required to apply IFRS 10 to determine whether it is a parent and, if so, the entities it controls

A Parent Company need not to prepare consolidated financial statement if it satisfies the mentioned conditions

- It is a WOS or Partially owned subsidiary of another entity
- Its debt or equity instruments are not traded in a public market whether domestic or foreign
- It didn't file or in the process of filing any financial documents to the securities commission or other regulatory body for issuance of any of its instrument in a public market
- Its ultimate or intermediate parent produces consolidated financials statements that are available for public use and comply with IFRS requirement.

Control - Criteria

An Investor controls an investee if and only if the investor has

- Power over the investee
- Exposure or rights to variable returns from its involvement with the investee and
- The ability to use its power over the investee to affect the amount of the investor's return

Control – Criteria (IFRS 10 vs. IAS 27)

IFRS 10	IAS 27
An Investor controls an investee when it is exposed or has rights, to variable returns from its involvement with investee and has ability to affect those returns through its power over the investee	Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities
	Requirement of SIC 12 : Following circumstances indicate control of a Special Purpose Entities (SPEs) -the activities of the SPE are being conducted on behalf of the entity so as to obtain benefits from SPEs operation -the entity has the decision making powers to obtain majority of the benefits of the activities of the SPE -the entity retains the majority of the residual or ownership risks related to the SPE

Control – Criteria (IFRS 10 vs. IAS 27)

Practical Implications of Revised Control Definitions
1 – IAS 27 refers to 'Power' but IFRS 10 refers to 'rights' and 'ability'
2 – IAS 27 refers to governing the financial and operating policies but IFRS 10 refers to the ability to affect returns
3 – IAS 27 refers to obtaining 'benefits' while IFRS 10 requires 'exposures or rights to variable returns'
4 – SIC 12 includes specific control indicators for SPEs while IFRS 10 does not

Control – Criteria (Cont.)

Assessing Control……

Diagram 1 – Assessing control

Identifying power

Power

Determine which party, if any, has power, that is, the current ability to direct the relevant actitivies. Power arises from the rights, which may include:

- Voting rights
- Potential voting rights (e.g., options or convertible instruments)
- Rights to appoint key personnel
- Decision making rights within a management contract
- Removal or 'kick-out' rights

However, power does not arise from protective rights.

Assessing returns

Returns

Assess whether the investor is exposed, or has rights, to variable returns from its involvement with the investee. Returns can be positive, negative or both.

Examples of returns include:

- Dividends
- Remuneration
- Economies of scale, cost savings, scarce products, proprietary knowledge, synergies, or other returns that are not available to other interest holders

Evaluate linkage

Linkage

Evaluate whether the investor has the ability to use its power to affect the investor's returns from its involvement with the investee. If applicable, determine whether the investor is a principal or an agent, considering:

- Scope of its authority
- Rights held by other parties
- Remuneration
- Exposure to variability from other interests

Understanding the purpose and design of the investee

Understanding the purpose and design of the investee

- The risk to which the entity is designed to be exposed
- What are the relevant activities?
- How are decisions about the said activities made?
- Who has the ability to direct the relevant activities?
- Which parties have exposure to variable returns from investee?
- DO the parties that have power and exposure to variable returns have the ability to use that power?

Power over an investee….1st Criteria

An investor has power when it has existing rights that give it the current ability to direct the relevant activities.

Relevant Activities

Activities of the investee that significantly affect the investee's returns

Examples could be:

- Determining financial or operating policies
- Selling and purchasing goods and services
- managing financial assets
- selecting, acquiring or disposing of assets
- R&D New Products
- Making Capital or funding decisions

Power over an investee….1st Criteria

An investor has power when it has existing rights that give it the current ability to direct the relevant activities.

Existing Rights

Examples could be:

- Voting Rights or Potential Voting Rights
- Rights to appoint, reassign, or remove members of KMP
- Right to appoint or remove another entity that directs the relevant activities
- Rights to direct the investee to enter into or veto any changes to transaction

Power over an investee – Identifying Relevant Activities

Assessing relevant activities is critical in following kind of a scenario…….

Two investors form an investee to develop and market a medical product. One investor is responsible for developing and obtaining regulatory approval of the medical product – that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval. Once the regulator has approved the product, the other investor will manufacture and market it – this investor has the unilateral ability to make all decisions about the manufacture and marketing of the project. If all the activities – developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product – are relevant activities, each investor needs to determine whether it is able to direct the activities that most significantly affect the investee's returns. Accordingly, each investor needs to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that most significantly affects the investee's returns and whether it is able to direct that activity. In determining which investor has power, the investors would consider:

(a) The purpose and design of the investee

(b) The factors that determine the profit margin, revenue and value of the investee as well as the value of the medical product

(c) The effect on the investee's returns resulting from each investor's decision-making authority with respect to the factors in (b); and

(d) The investors' exposure to variability of returns.

In this particular example, the investors would also consider:

(e) The uncertainty of, and effort required in, obtaining regulatory approval (considering the investor's record of successfully developing and obtaining regulatory approval of medical products); and

(f) Which investor controls the medical product once the development phase is successful.

Power over an investee – Identifying Relevant Activities

Example

Investors A and B establish Entity C and each holds 50% of the voting rights. The shareholders' agreement between A and B specifies that:

- Entity C's purpose is to generate capital gains from investing in commercial property. Its activities are limited to buying, managing and selling properties that meet pre-determined investment criteria
- all decisions concerning major capital activities, including buying and selling properties, and associated financing activities, require the agreement of both investors
- Investor A is responsible for other day-to-day management activities, including marketing to prospective tenants, negotiating rental agreements, rent collection and property maintenance, security and insurance. Investor A is paid for these services on the basis of costs incurred plus a fixed margin.

Power over an investee – Identifying Relevant Activities

Example

Bank A establishes Entity B – a limited life entity with a narrow and well-defined purpose to acquire a portfolio of Bank A's originated mortgage loans. Entity B funds the purchase by issuing loan notes to various third party investors. Once these initial transactions have been completed, Entity B will not undertake any further investing or financing activities. The only continuing activities relate to:

- managing the loans, including collecting the amounts due and management of any defaults
- basic administrative functions.

Power over an investee – Directing Relevant Activities

<u>Example</u>

Bank A establishes a special purpose vehicle, Entity B, and owns 100% of its shares. Entity B simultaneously enters into a trade receivables factoring agreement with Company C. The agreement sets out the terms on which Entity B will purchase Company C's receivables, and the terms of financing provided by Bank A for that purpose. The agreement provides that Company C will continue to be responsible for collecting and managing the receivables, including in the event of default. Company C is also required to provide a guarantee that losses on the transferred receivables will not exceed a specified percentage.

Entity B's articles of association restrict its activities to this specific factoring programme.

The shares held by Bank A confer the general range of voting rights associated with shares but cannot override the restriction on Entity B's activities, or invalidate the contract with Company C.

Existing Rights – Should be Substantive

Factors	Examples
▸ Are there barriers (economic, operational or otherwise) that would prevent (or deter) the holder(s) from exercising their right(s)?	▸ Financial penalties ▸ High exercise or conversion price ▸ Narrow exercise periods ▸ Absence of a mechanism to exercise ▸ Lack of information to exercise ▸ Lack of other parties willing or able to take over ▸ Legal or regulatory barriers
▸ Do the holders have the practical ability to exercise their rights, when exercise requires agreement by more than one investor?	▸ The more parties necessary to come together to exercise this right, the less likely that the right is substantive ▸ A mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so ▸ An independent board of directors may serve as a mechanism for numerous investors to act collectively in exercising their rights
▸ Would the investor that holds the rights benefit from their exercise or conversion?	▸ A potential voting right is "in-the-money" ▸ An investor would obtain benefits from synergies between the investor and the investee
▸ Are the rights exercisable when the decisions about the relevant activities need to be made?	▸ An investor has rights that are currently exercisable, but has not yet exercised them ▸ An investor can direct certain activities of an investee when a particular circumstance or event occurs

Rights could be Protective and not Substantive

- Protective rights are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.
- Since power is an essential element of control, protective rights do not give the investor control over the investee.
- Holding protective rights cannot prevent another investor from having power over an investee.

Examples of Protective Rights

- Restrict an investee from undertaking activities that could significantly change the credit risk of the investee to the detriment of the investor
- Approve an investee’s capital expenditures (greater than the amount spent in the ordinary course of business)
- Approve an investee’s issuance of equity or debt instruments
- Seize assets if an investee fails to meet specified loan repayment conditions
- Veto transaction between investee and related party

Rights could be Protective and not Substantive

Example

Acquirer A is in negotiation with Vendor V to acquire 100% of the share capital of Entity B (the acquiree). Entity B is currently wholly-owned by Vendor V and operates a business (as defined in IFRS 3). Legal completion of the transaction (ie transfer of legal title to the shares in Entity B and payment of the consideration) is subject to approval by both Acquirer A's shareholders and the jurisdictional competition authority.

Acquirer A and Vendor V enter into an agreement that:

- commits both parties to legal completion subject to obtaining the required approvals
- commits both parties to use best endeavours to obtain these approvals
- specifies the purchase price, subject to adjustment for working capital movements between the agreement date and completion date
- specifies that the following decisions and actions can be undertaken by Vendor V only with the consent of Acquirer A:
  - changes in the management of Entity B
  - dividend payments
  - constitution amendments
  - new contracts or charges in excess of a specified value
  - ceasing any business or starting a new business
  - changes to employee and directors remuneration in excess of 5%.

Does Acquirer A obtain control over Entity B on the date of this agreement (or only on the completion date)?

Exposure to variable returns – 2nd Criteria

Examples of exposure to variable returns	Dividends, fixed interest on debt securities that expose the investor to the credit risk of the issuer, variable interest on debt securities
	Remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee
	Economies of scale, cost savings, scarce products, proprietary knowledge, synergies, or other exposures to variable returns that are not available to other investors

An investor assesses whether the exposure to returns are variable based on the substance of the arrangement and not the legal form of the returns. An investor with fixed interest payment is exposed to variable return considering the credit risk to which the investor is exposed.

Exposure, or rights to variable returns…..2^{nd} Criteria

<u>Example</u>

Entity B is a bank in the US and Entity S is an information technology (IT) outsourcing company in India. Entities B and S form a new Entity C, with the sole activity of providing IT services to B on an outsourced basis. Some key facts relating to the arrangement are as follows:

- Entity B owns 51 'class A' shares' and Entity S owns 49 'class B' shares in Entity C, representing 100% of each class
- the two classes of shares each confer one vote per share, such that Entity B holds 51% of the total votes
- all residual profits or losses of the venture, and rights to receive more than the nominal value on liquidation, accrue to the 'class B' shares owned by Entity S
- Entity B pays for services received on the basis of a partly fixed fee, and a variable element that results in the sharing of operational efficiencies between B and C
- Entity C's Board of Directors has 5 members, three appointed by Entity B and two by Entity S. The Board controls most significant decisions, which are taken by simple majority vote. The CEO is nominated by Entity S but reports to and functions under the direction of the Board
- most middle management staff are former employees of Entity S who bring in the operational expertise
- the service delivery management of the venture is the most relevant activity, and this is managed on a day- to-day basis by Entity S under the overall oversight of the Board
- operations of the venture are carried out from premises of Entity S.

Ability to use power to affect return…..3rd Criteria

Linkages

The linkage of power and ability to use the power depends on whether the investor has the current ability to direct the relevant activities:

-on its own (as principal) or

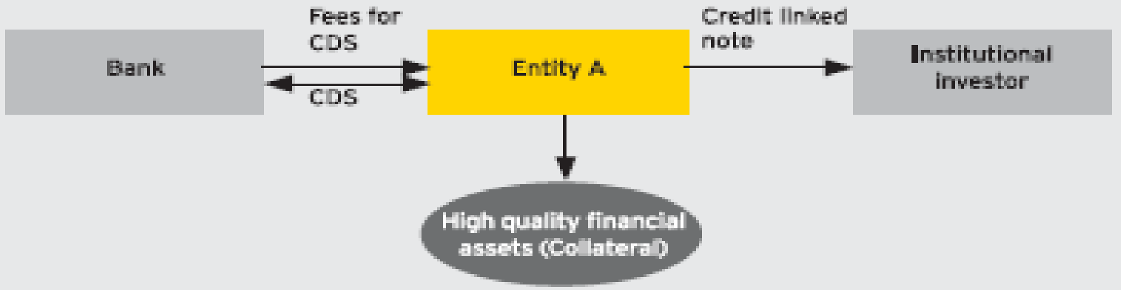
-on behalf of other investors that have delegated their powers to it (as agent)

<u>Example</u>

Fund Manager A has 45% shareholding in Fund B, which it also manages within defined parameters. The constitution of the fund defines the fund's purpose and sets out the investment parameters within which the fund manager can invest. The constitution also requires Fund Manager A to act in the best interests of the shareholders. Within the defined parameters, however, the investment manager has discretion about the assets in which Fund B will invest

Structured Entity – IFRS 10 vs. SIC 12

<u>Example</u>



Fact pattern

A structured entity A is created for the benefit of an investor who wishes to obtain exposure to the credit risk of Entity B (an entity which is unrelated to any party involved in the structure). The structured entity obtains funding by issuing a note that is linked to Entity B's credit risk. The proceeds are used to acquire a portfolio of high quality financial assets. The structured entity obtains exposure to Entity B's credit risk by entering into a credit default swap (CDS) at market rates with a bank in return for a fee paid by the bank.

The structured entity operates virtually on autopilot and there are very few, if any, decisions to be made after initial set up. The bank can switch the collateral assets within pre-defined parameters, but that ability only affects the returns of the structured entity to a small extent.

Who will consolidate Entity A ? – Whether the Bank or the Institutional Investor ?

Structured Entity – IFRS 10 vs. SIC 12

<u>Analysis (Considering IFRS 10 Requirement)</u>

It seems that there are no relevant activities that affect structured entity's return post inception. The Bank's ability to switch the collateral would also not affect much the return attributable to the structured entity.

Despite the fact that the structured entity was created for the benefit of the Investor, the investor has no power over the entity and so would not have control over the entity. As a result no party would consolidate the structured entity.

If the fact pattern was varied such that the investor had the unilateral power to dissolve the structured entity at any time, then it would most likely be considered to have power over a relevant activity and so would be required to consolidate the entity.

<u>Analysis (Considering SIC 12 Requirement)</u>

Structured Entity – IFRS 10 vs. SIC 12

<u>Example</u>

Suppose the fact pattern is similar to last example with two amendments : 1) there is more than one investor and 2) the Bank has the right to vary the debt securities which constitute the CDS reference portfolio.

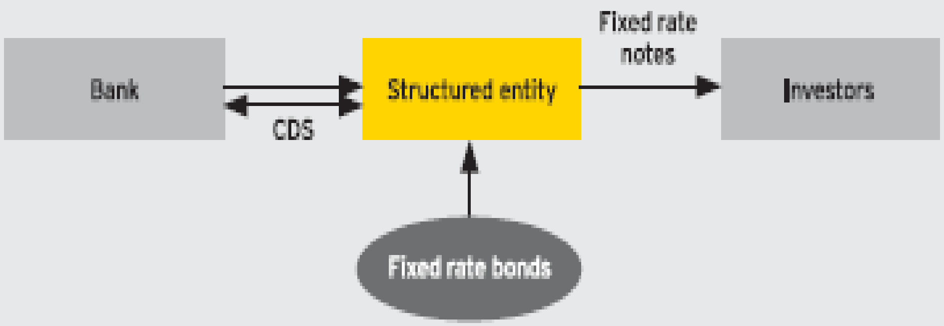
Structured Entity – IFRS 10 vs. SIC 12

Analysis (Considering IFRS 10 Requirement)

Analysis (Considering SIC 12 Requirement)

Structured Entity – IFRS 10 vs. SIC 12

Example



Fact pattern

A bank establishes a structured entity that purchases fixed rate bonds from the market. The structured entity issues fixed rate notes to investors, which pay a return based on the cash flows generated from the bond portfolio. To reduce the structured entity's exposure to credit risk from the bonds, the structured entity purchases a CDS from the bank. The structured entity delegates management of bonds in default to the bank.

Analysis (Considering IFRS 10 Requirement)

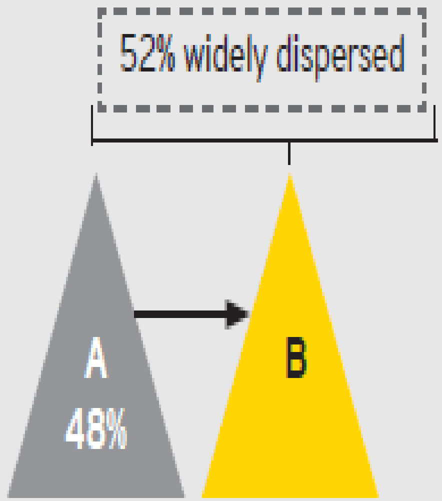
Analysis (Considering SIC 12 Requirement)

Power without majority voting rights – de facto control

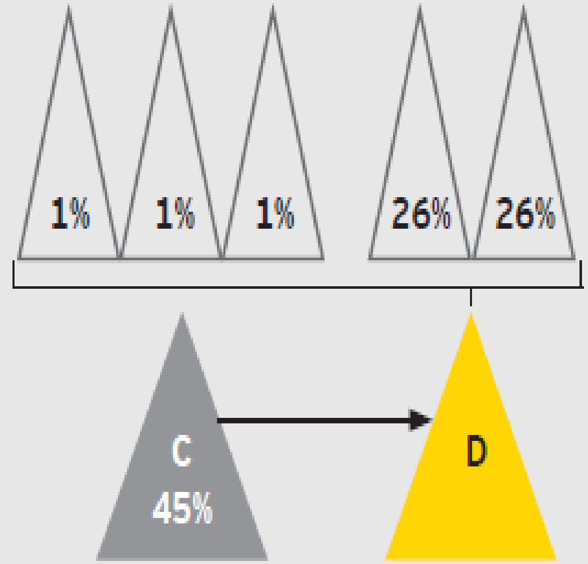
- Assessing investor’s voting rights
  - Size of holding of the voting rights
    - the more the voting rights, the more likely the investor has existing right
    - the more parties that would need to outvote the investors, the more likely…..
  - Potential voting rights held by the investor, other vote holders, or other parties
  - Rights arising from other contractual arrangement
  - Any other facts and circumstances that indicate, the investor has…

Power without majority voting rights – de facto control

A holds 48% of the voting rights of B; the remaining 52% of B is widely held by thousands of shareholders (none of whom holds more than 1% of the voting rights).



C holds 45% of the voting rights of D. The other 55% of D is held by two shareholders (each holds 26%), with the remaining 3% held by three other shareholders, each holding 1%.



<u>IFRS 10 does not specify any thresholds to determine when an analysis of distribution of voting rights is sufficient to reach a conclusion and when additional facts and circumstances must be considered.</u>

Power without majority voting rights – de facto control

Example – Voting pattern of other shareholders at a recent meeting

An investor holds 35% of the voting rights of an investee. Three other shareholders each hold 5% of the voting rights of the investee. The remaining 50% of the voting rights are held by numerous other shareholders, none individually holding more than 1%. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities are directed by a simple majority of the votes cast at shareholders' meetings. At recent meetings, 75% of the total voting rights have been cast (including the investor's votes).

Power without majority voting rights – de facto control

Example

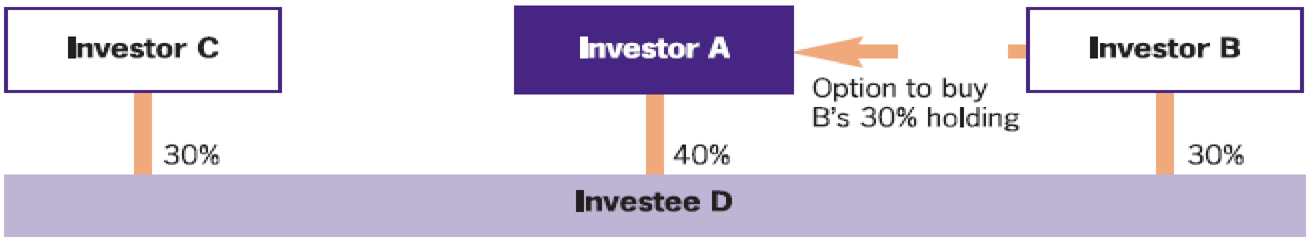
Investor A, an entity operating in a high technology industry, establishes a new venture in an overseas jurisdiction. The corporate law in this jurisdiction prohibits majority foreign ownership. Accordingly, Investor A identifies a local partner (B) to co-invest. Ownership and voting rights are split 49% and 51% between the investor and local partner. The new venture's Board comprises five directors of which Investor A is entitled to appoint two and local partner B three. All relevant activities are directed by the Board. However, because the Investor A has superior industry knowledge, the local investor agrees to an initial Board comprising four current employees of Investor A and only one representative of its own. Although the composition of the Board can be changed at future meetings, Investor A expects that it will in practice be able to continue to appoint the majority of the Board because of its superior industry knowledge and expertise.

Potential Voting Rights

Criteria	IFRS 10	IAS 27
Exercise Price	not at a level that prevents or deters exercise	not at a level that precludes exercise in any feasible scenario
Timing of exercisability	exercisable in time to affect key decisions	currently exercisable
Intent to exercise	apparent expectation, motives and reasons are part of the assessment	no specific guidance and intent to exercise is not considered generally
Financial ability	required to be considered	no specific guidance and not generally considered
Operational barrier	relevant if investor does not have practical ability to exercise	no specific guidance and not generally considered

Potential Voting Rights

Example – Potential Voting Rights - Basic Ownership Structure

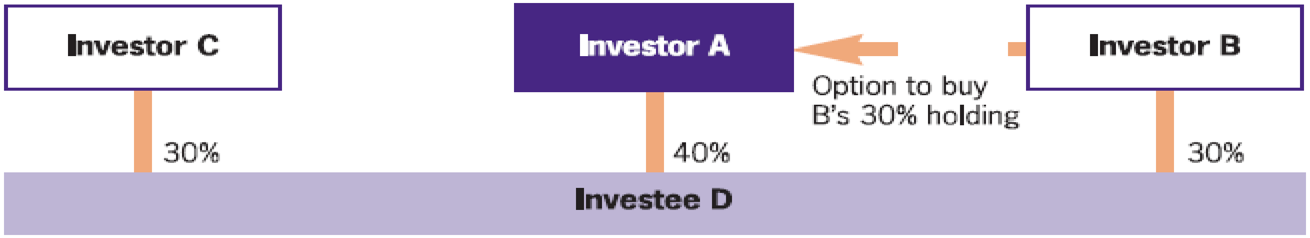


Example - 1

Investor A's option has been acquired recently and is exercisable at any time in the next two years. The exercise price is fixed. The fixed price exceeds the current fair value of the underlying shares by 30%.

Potential Voting Rights

Example – Potential Voting Rights - Basic Ownership Structure



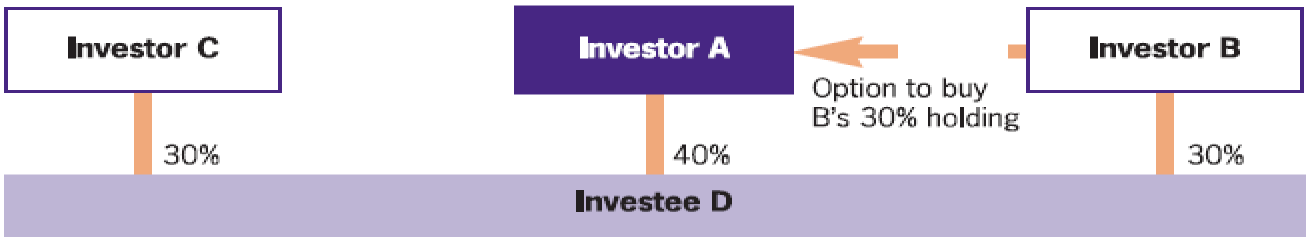
Example - 2

Investor A's option has been acquired recently and is exercisable in 30 days' time and then at any time in the following 12 months. The exercise price is based on a formula that is designed to approximate fair value of the underlying shares at each exercise date.

An annual shareholders' meeting is scheduled in six months' time. Any existing shareholder is also able to call a special meeting, on giving 45 days' notice to other shareholders. Members of the management committee (which directs Investee D's relevant activities) are elected or removed at these meetings by a simple majority of shareholder votes cast.

Potential Voting Rights

Example – Potential Voting Rights - Basic Ownership Structure



Example - 3

Investor A's option is exercisable at any time in the next two years at a fixed exercise price that exceeds the current estimated fair value of the underlying shares by 30%. However, Investor A's intention in purchasing this option was not to obtain control of Investee D, but instead to prevent Investor B from obtaining control by acquiring Investor C's shares. Investor A would be prepared to exercise, and pay the required premium, to block Investor B but is otherwise content to remain a long-term strategic (but non-controlling) investor.

Franchises

Franchisee Arrangement

- Analyze the purpose and design of the franchisee
- Determine the relevant activities
- Determine which investor (Franchisor or the owner of the franchisee) has the ability to direct the activities
- Rights held by franchisor must be substantive and not protective

Franchisee (Cont.)

<u>Example</u>

Franchisor A owns the trade name and business model-related IP for a fast food business. Franchisee B enters into an agreement giving it exclusive rights to operate the franchise business in a specified location for 5 years, renewable at B's option. Franchisee B pays an initial franchise fee, continuing royalties of 5% of revenues, and fees for advertising and other services. Franchisee B is entitled to all residual profits after paying these fees.

Under the terms of the agreement:

- Franchisor A sets the selling price for core products, determines branding requirements and determines a list of approved suppliers for key food supplies and negotiates the related prices
- Franchisee B is responsible for all other aspects of the operation including:
  - financing the franchise
  - fit-out (subject to A's approval of the design for brand compliance), equipment purchasing and negotiating the lease for premises
  - hiring management and employees and negotiating wages and other employment terms
  - determining detailed operating procedures
  - local advertising and promotion
  - renewing the franchise.

Consolidation Procedure

Consolidation Process - Key Steps

	Key Steps	Common practical issues
Step 1	Combine financial statement of each group entity	-uniform accounting policies -reporting dates -overseas subsidiaries -immaterial subsidiaries -changes in group composition
Step 2	Eliminate intra group transactions and balances	-intra group losses -tax effects -intra group arrangements
Step 3	Eliminate the parent's investment in each subsidiary and recognize goodwill and other business combination related assumption	-business combination adjustment -Goodwill impairment
Step 4	Allocate comprehensive income and equity to non-controlling interests	-determining ownership percentage -NCI valuation method

Consolidation Process - Key Steps

Example – Accounting policy alignment

Parent company P heads a property investment group that includes subsidiaries S1 and S2. P's group accounting policy for investment property is to apply the fair value model in accordance with IAS 40 'Investment Property'. In their individual financial statements S1 also applies the fair value model but S2 uses the cost model.

Both S1 and S2 use interest rate swaps to manage interest rate risk on floating rate borrowings. However, S1 applies hedge accounting and S2 does not.

Example – Reporting dates

Parent company P is preparing consolidated financial statements to 31 March 20X1. For this purpose, it uses statutory, IFRS-based financial statements for Subsidiary S. S has a year end of 31 December 20X0.

In February 20X1 Subsidiary S sold a property held at cost, realising a large profit that is material to the consolidated financial statements.

Consolidation Process - Key Steps

Example – Eliminating Intragroup loss

Parent company P acquired an item of property 8 years ago at a cost of CU200. P estimates the economic useful life to be 20 years and residual value to be zero. P has recorded accumulated depreciation of CU80 to 1 January 20X1 and carrying value at that date is CU120.

On 1 January 20X1 P sells the property to Subsidiary S for CU100, incurring a loss of CU20. S records the property at cost of CU100. S records depreciation of CU8.3 in the year to 31 December 20X1 (resulting in a carrying value of CU91.7).

Consolidation Process - Key Steps

Example – Tax effect on intra group elimination (Continuation of last example)

- when S purchases the property for CU100 on 1 January 20X1 the tax base for S is equal to cost (ie also CU100)
- in the 12 months to 31 December S receives tax allowances of CU20, reducing the tax base to CU80
- S's tax rate is 25%.

Consolidation Process - Key Steps

Example – Eliminating Parent's Investment

Some years ago Parent P acquired 80% of the issued share capital of Subsidiary S for CU5,000. At that time S's balance sheet showed net assets of CU4,000. Fair value adjustments totalling CU800 were recognised in the business combination. P decides to recognise non-controlling interests using the proportionate share of net assets method rather than fair value (see paragraph 19 of IFRS 3 'Business Combinations').

S's summary balance sheet is therefore:

	Individual financial statements	Fair value adjustment	Total
	CU	CU	CU
Net assets	**4,000**	800	4,800
Share capital	2,500		
Other reserves	1,500		
	4,000		

Consolidation Process - Key Steps

Example – Indirect Holdings

Parent P controls two subsidiaries – S1 & S2. P holds 90% stake in S1 and 30% stake in S2. S1 also holds 40% stake in S2. Both the subsidiaries are established as start ups. The summarized financial statements are given below

	Parent P	S1	S2	Total
	CU	CU	CU	CU
Investment in S1	810	–	–	810
Investment in S2	150	200	–	350
Other net assets	340	1,310	750	2,400
	1,300	1,510	750	3,560
Share capital	1,000	900	500	2,400
Retained earnings	300	610	250	1,160
	1,300	1,510	750	3,560

Consolidation Process - Key Steps

Example – Indirect Holdings (Cont.)

The effective controlling and non-controlling interest percentages are:

	S1	S1*	S2**	S2
	%	CU	%	CU
Controlling interests	90	1,179	66	495
Non-controlling	10	131	34	255
	100	1,310	100	750

The consolidated statement of financial position is as follows:

	CU
Net assets	**2,400**
Equity attributable to owners of P:	
– Share capital	1,000
– Retained profit	1,014
	2,014
Non-controlling interests:	
– In subsidiary S1	131
– In subsidiary S2	255
	2,400

Consolidation Process – Potential Voting Rights & Other Derivatives

If parent holds PVRs in a subsidiary, the controlling and non-controlling percentages are normally based on existing ownership interests.

The allocation does not reflect the possible exercise of PVRs.

However, as an exception to this rule, an instrument that ‘currently gives the entity access to the returns associated with an ownership interest’ is regarded as an ownership interest in substance. The allocation takes into account the eventual exercise of the PVRs.

Following could be such instruments:

-A fixed price forward contract between the parent and non controlling owner to buy or sell shares in the subsidiary at future date

-A combined put and call option with a fixed exercise price

-A fixed price put or call option that is deeply in the money at inception such that exercise is virtually certain

Consolidation Process – Potential Voting Rights & Other Derivatives

Example

Parent P owns 80% of the ordinary shares of Subsidiary S. Minority shareholder M owns remaining 20%. P purchases an option to acquire 20% holding owned by M for a fixed price in 12 months' time. The exercise price is based on estimated fair value of 20% holding at inception. Dividend rights are not affected by the call option. Dividends are material and are paid regularly.

Example

Suppose, Parent P and shareholder M negotiate both a call option for P and put option for M . The price in the put and call options are same and is fixed at inception. Dividend has not been paid in recent years.

Consolidation Process – Loss of Control

On loosing control of a subsidiary, the parent:

-Derecognizes the assets & liabilities of the subsidiary at carrying value
-Derecognizes the NCI
-Recognizes the fair value of considerations received
-Recognizes any investment retained at Fair Value
-Reclassifies to P&L or transfers directly ro Retained Earnings any amounts included in OCI
-Recognizes any resulting gain or loss within profit or loss attributable to the parent

Example

Parent P acquired its wholly-owned subsidiary, Company R, for CU1,000 on 1 January 20X5. On 31 December 20X9, Parent P sold 90% of its interest in Company R for cash of CU1,440. On that date, the carrying value of the net assets of Company R is CU1,350. These net assets include goodwill and a financial asset classified as an available for sale investment with a fair value of CU200 and original cost of CU150. Company R applied the revaluation model of IAS 16 for its property, plant and equipment and has a revaluation reserve balance of CU60. For the purposes of this example, income tax on the gain on sale of Company R is ignored.

Consolidation Process – Loss of Control

Solution

	CU
Cash consideration	1,440
Fair value of retained investment (financial asset)	160
Subtotal	1,600
Carrying value of net assets	1,350
Gain	250
Add: available for sale reserve reclassified to profit or loss	50
Total gain	**300**

	Debit CU	Credit CU
Cash	1,440	
Financial asset	160	
Available for sale investment reserve	50	
Identifiable net assets and goodwill		1,350
Gain (profit or loss)		300

Any Revaluation reserve is transferred to Retained Earnings

	Debit CU	Credit CU
Revaluation reserve	60	
Retained earnings		60

Thank You!!!

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