



IFRS[®]
Accounting

Educational Module 9
Consolidated and Separate Financial Statements

IFRS for SMEs[®]

Accounting Standard

Third Edition



International Accounting Standards Board

IFRS[®] Foundation
Supporting Material for the
***IFRS for SMEs[®]* Accounting Standard**

including the full text of
Section 9 *Consolidated and Separate Financial Statements*
of the *IFRS for SMEs* Accounting Standard issued by
the International Accounting Standards Board in February 2025

with extensive explanations, self-assessment questions and case studies

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The requirements of Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Accounting Standard are set out in this module and shown with grey shading. Appendix B of the *IFRS for SMEs* Accounting Standard contains the glossary (Glossary) and is part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 9.

This module has been prepared by the International Accounting Standards Board (IASB) technical staff. The educational notes and examples inserted by the staff are not shaded. These educational notes and examples do not form part of the *IFRS for SMEs* Accounting Standard and have not been approved by the IASB.

INTRODUCTION

IFRS for SMEs® Accounting Standard

The *IFRS for SMEs* Accounting Standard (Standard) is intended for use by entities that publish general purpose financial statements and that do not have public accountability (referred to as small and medium-sized entities—see Section 1 *Small and Medium-sized Entities* of the Standard).

The objective of general purpose financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

More information about the Standard and its supporting materials is available on the IFRS Foundation website: www.ifrs.org.

This module

This educational module supports the requirements for presenting financial statements applying Section 9 *Consolidated and Separate Financial Statements* of the Standard. This module:

- provides explanations and examples to improve understanding of the requirements in Section 9;
- identifies the significant judgements required in preparing consolidated and separate financial statements;
- includes questions designed to test your understanding of the requirements in Section 9; and
- includes case studies that provide a practical opportunity to apply the requirements in Section 9.

After completing the module, you should be able:

- to identify parent–subsidiary relationships;
- to determine if a parent is required to present consolidated financial statements;
- to prepare consolidated financial statements;
- to account in the separate financial statements of the parent for investments in subsidiaries, jointly controlled entities and associates, if any;

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- to prepare combined financial statements, if any; and
 - to identify the disclosures required to be made in consolidated, separate and combined financial statements.

Which version of the Standard does this module refer to?

Any reference in this module to ‘the *IFRS for SMEs Accounting Standard*’ is to the third edition of the Standard, issued February 2025.

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity that is useful to existing and potential investors, lenders and other creditors when making decisions relating to providing resources to the entity.

The objective of Section 9 *Consolidated and Separate Financial Statements* is to prescribe the circumstances in which an entity presents consolidated financial statements and to prescribe the financial reporting requirements for preparing consolidated, separate and combined financial statements.

Consolidated financial statements

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

Except in the circumstances set out in paragraphs 9.3 and 9.3C of Section 9, the Standard requires a parent to present consolidated financial statements.

Identifying a subsidiary often requires significant judgement if the parent does not own a majority of the voting rights in an investee. The Glossary defines a subsidiary as ‘an entity that is controlled by another entity’.

Separate financial statements

The Standard does not require an entity to present separate financial statements.

However, if an entity does prepare separate financial statements, Section 9 requires the entity to choose an accounting policy for its investments in subsidiaries, jointly controlled entities and associates in those financial statements. The entity can adopt one of three accounting policies: cost less impairment, fair value with changes in fair value recognised in profit or loss, or the equity method.

Combined financial statements

The Standard does not require an entity to present combined financial statements.

The fundamental principle of combined financial statements is that they present financial information about two or more entities that are not all linked by a parent–subsidiary relationship.

What has changed in the third edition of the Standard?

The IASB changed Section 9 in the third edition of the Standard by:

- amending the definition of ‘control’ and clarifying the application of the rebuttable presumption (see paragraphs 9.4–9.12);
- adding requirements for a parent that loses control of a subsidiary, including how to measure any retained interest in a former subsidiary at its fair value at the date control is lost (see paragraphs 9.18–9.19);
- relocating requirements on changes in a parent’s controlling interest in a subsidiary from Section 22 *Liabilities and Equity* to Section 9 (see paragraph 9.20A);
- removing the requirement to disclose the basis for concluding that control exists if the parent does not own more than half of the voting power in the other entity (see paragraph 9.23(b));
- adding a requirement to disclose information on losing control of a subsidiary if the former parent retains an interest in the former subsidiary (see paragraph 9.23B);
- specifying that a parent that is exempt in accordance with paragraph 9.3 from preparing consolidated financial statements is permitted to present separate financial statements as its only financial statements (see paragraph 9.25A); and
- adding requirements for an entity that prepares separate financial statements to disclose additional information (see paragraph 9.27(c)).

Transition requirements for these changes are explained on page 97–99 of this educational module.

REQUIREMENTS AND EXAMPLES

Scope of this section

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

Educational notes

The Glossary defines consolidated financial statements as ‘the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity’.

Separate financial statements are defined in the Glossary as ‘those presented by an entity, in which the entity could elect, in accordance with paragraphs 9.25–9.26, to account for its investments in subsidiaries, jointly controlled entities and associates either at cost less impairment, at fair value with changes in fair value recognised in profit or loss or using the equity method following the procedures in paragraph 14.8’. For example, a parent with two subsidiaries prepares consolidated financial statements applying Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs Accounting Standard* (Standard), unless it is exempt by paragraph 9.3 or 9.3C. If the parent also prepares separate financial statements, it is permitted to choose an accounting policy for those subsidiaries in its separate financial statements: at cost less impairment, at fair value with changes in fair value recognised in profit or loss, or using the equity method.

Combined financial statements are financial statements of a reporting entity that comprises two or more entities that are not all linked by a parent–subsidiary relationship. Combined financial statements often present financial information about entities that are controlled by the same investor (or investors) as if those entities were a single entity. For example, an individual might own all of the issued share capital of three entities and decide to publish financial statements combining the results and assets of the three entities as if the entities were a single entity.

Requirement to present consolidated financial statements

- 9.2 Except as permitted or required by paragraphs 9.3 and 9.3C, a parent shall present consolidated financial statements. Consolidated financial statements shall include all **subsidiaries** of the parent, except subsidiaries to which paragraph 9.3A applies.

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- 9.3 A parent need not present consolidated financial statements if both of the following conditions are met:
- (a) the parent is itself a subsidiary; and
 - (b) its ultimate parent (or any intermediate parent) produces consolidated **general purpose financial statements** that comply with full IFRS Accounting Standards or with this Standard.

Educational notes

The Glossary defines a parent as ‘an entity that controls one or more entities’ and a subsidiary as ‘an entity that is controlled by another entity’. A parent is required to present consolidated financial statements for all its subsidiaries, unless it is exempt from presenting consolidated financial statements (see paragraph 9.3) or the subsidiaries are excluded from consolidation (see paragraph 9.3A).

Examples—Not exempt from presenting consolidated financial statements

Ex 1 SME B has a subsidiary, SME C. SME B’s immediate and ultimate parent is SME A. SMEs A, B and C do not have public accountability. SMEs A, B and C produce general purpose financial statements. SMEs B and C do so in accordance with the Standard while SME A presents consolidated financial statements in accordance with local generally accepted accounting principles (GAAP). This GAAP is required or permitted in the jurisdiction in which SME A reports, and is neither the Standard nor full IFRS Accounting Standards.

SME B is required to present consolidated financial statements in accordance with the Standard because SME B is a parent (SME C is a subsidiary of SME B) (see paragraph 9.2). SME B does not meet the terms of the exemption in paragraph 9.3 because its parent, SME A, does not prepare consolidated general purpose financial statements in accordance with either the Standard or full IFRS Accounting Standards.

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

SME B is required to present consolidated financial statements in accordance with the Standard because SME B is a parent (see paragraph 9.2). SME B does not meet the terms of the exemption in paragraph 9.3 because its parent, Entity A, does not prepare consolidated general purpose financial statements in accordance with either the Standard or full IFRS Accounting Standards.

Examples—Exempt from presenting consolidated financial statements

- Ex 3** SME B has a subsidiary, SME C. SME B's immediate and ultimate parent is SME A. SMEs A, B and C do not have public accountability. They produce general purpose financial statements in accordance with the Standard. Consequently, SME A presents consolidated financial statements.

SME B is not required to present consolidated financial statements because SME A, its ultimate parent, presents consolidated general purpose financial statements in accordance with the Standard.

- Ex 4** The facts are the same as in Example 3. However, in this example, SME B's immediate and ultimate parent is Entity A, which has public accountability and is therefore not permitted to apply the Standard. Entity A produces consolidated general purpose financial statements in accordance with full IFRS Accounting Standards.

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

- Ex 5** SME C has a subsidiary, SME D. SME C's parent is SME B and SME B's parent is SME A. SMEs A, B, C and D do not have public accountability. They produce general purpose financial statements. SMEs B, C and D do so in accordance with the Standard and SME A presents consolidated financial statements in accordance with local GAAP.

SME C is not required to present consolidated financial statements because its immediate parent, SME B, presents consolidated general purpose financial statements in accordance with the Standard. SME B is required to present consolidated financial statements in accordance with the Standard because its parent does not present consolidated general purpose financial statements in accordance with either the Standard or full IFRS Accounting Standards.

- Ex 6** SME C has a subsidiary, SME D. SME C's parent is SME B and SME B's immediate and ultimate parent is SME A. SMEs A, B, C and D do not have public accountability. They produce general purpose financial statements. SMEs A, C and D do so in accordance with the Standard and SME B does so in accordance with local GAAP.

SME C is not required to present consolidated financial statements because its ultimate parent, SME A, presents consolidated general purpose financial statements in accordance with the Standard.

Ex 7 SME B has a subsidiary, SME C. SME B is a subsidiary of SME A. SME A owns 70% of SME B and the remaining shares are held by three individuals. SMEs A, B and C do not have public accountability. They produce general purpose financial statements in accordance with the Standard.

SME B is not required to present consolidated financial statements because its ultimate parent, SME A, prepares consolidated general purpose financial statements in accordance with the Standard. It does not matter that SME B is not wholly owned by SME A.

- 9.3A Subject to paragraph 9.3B, a subsidiary is not consolidated if it is acquired and is held with the intention of selling or disposing of it within one year from its acquisition date (see paragraph 19.11). Such a subsidiary is accounted for in accordance with the requirements in Section 11 *Financial Instruments* for investments in paragraph 11.8(d), instead of in accordance with this section. The parent shall also provide the disclosure required in paragraph 9.23A.
- 9.3B If a subsidiary previously excluded from consolidation in accordance with paragraph 9.3A is not disposed of within one year from its acquisition date:
- (a) the parent shall consolidate the subsidiary from the acquisition date unless it meets the condition in paragraph 9.3B(b). Consequently, if the acquisition date was in a prior period, the relevant prior periods shall be restated.
 - (b) if the delay is caused by events or circumstances beyond the parent's control and there is sufficient evidence at the **reporting date** that the parent remains committed to its plan to sell or dispose of the subsidiary, the parent shall continue to account for the subsidiary in accordance with paragraph 9.3A.
- 9.3C If a parent has no subsidiaries other than subsidiaries that are not consolidated in accordance with paragraphs 9.3A–9.3B, it shall not present consolidated financial statements. However, the parent shall provide the disclosure required in paragraph 9.23A.

Educational notes

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

An entity that has no subsidiaries other than those acquired and held with the intention of being sold or disposed of within one year from their acquisition date does not prepare consolidated financial statements in accordance with the Standard.

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

Ex 8 SME A, a manufacturer of eco-friendly bags, acquired SME B, which operates in the same industry. SME B has a subsidiary, SME C, which produces plastic bags. At the acquisition date, SME A intends to sell SME C within six months because SME C's business does not align with SME A's focus on sustainability. SME A has no other subsidiaries.

SME A does not consolidate SME C because it was acquired with the intention of selling within one year. If the fair value of SME C's shares can be determined reliably without undue cost or effort, in accordance with Section 11, SME A recognises and measures its investment at fair value with changes in fair value recognised in profit or loss. Otherwise, SME A recognises and measures its investment at cost less impairment (see paragraphs 11.8(d) and 11.14(c) of Section 11).

SME A consolidates SME B in accordance with the Standard.

9.3D A subsidiary is not excluded from consolidation because:

- (a) the investor is a venture capital organisation or similar entity.
- (b) its business activities are dissimilar to those of the other entities within the consolidation. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries.
- (c) it operates in a jurisdiction that imposes restrictions on transferring **cash** or other **assets** out of the jurisdiction.

Educational notes

Venture capital organisations generate income by owning equity in the entities in which they invest. A venture capital organisation that is a parent is required to consolidate its subsidiaries. This requirement includes situations in which the parent's business activities are different from those of the other entities in the group.

Furthermore, a parent is required to consolidate its subsidiaries, even if their business activities are different from those of the other entities in the group or the jurisdiction places limits or restrictions on transferring cash or assets.

Example—Consolidation of subsidiaries owned by venture capital organisations

Ex 9 SME A, a portfolio manager, invests in entities with high growth potential that operate in industries that are characterised by high technological risk. SME A aims to generate income primarily from their capital growth.

SME A acquires 65% of the ordinary shares of SME B, to which voting rights are attached. In accordance with paragraph 9.5, SME A determines it controls SME B. SME B is currently developing artificial intelligence software for retailing companies.

SME A is required to include SME B in its consolidated financial statements. SME A controls SME B and cannot exclude a subsidiary from consolidation because it is a venture capital organisation.

Example—Consolidation of subsidiaries with dissimilar business activities

Ex 10 SME A manufactures motor vehicles. SME A has two subsidiaries—one constructs bridges and the other is a bakery.

SME A is required to consolidate both its subsidiaries with its motor-vehicle manufacturing operations in its consolidated financial statements. A subsidiary cannot be excluded from consolidation because it has a different business activity from the other entities within the consolidation.

Example—Consolidation of subsidiaries operating in a jurisdiction where transfer of assets out of that jurisdiction is restricted

Ex 11 SME A is located and operates in Jurisdiction X. SME A holds all of the ordinary shares of SME B, to which voting rights are attached. SME A has determined it controls SME B. SME B operates in Jurisdiction Z, which has foreign-exchange-control regulations that restrict the repatriation of profits to foreign shareholders. The restriction limits transfers of cash or other assets out of the jurisdiction to a maximum of 10% of an entity's profits for the year.

SME A is required to consolidate SME B regardless of the restriction on the transfer of cash and other assets in Jurisdiction Z. A subsidiary cannot be excluded from consolidation because it operates in a jurisdiction that imposes restrictions on transferring cash or other assets out of the jurisdiction.

Control

- 9.4 A subsidiary is an entity (an investee) that is controlled by another entity (an investor). An investor, regardless of the nature of its involvement with an investee, shall determine whether it is a parent by assessing whether it **controls** the investee.
- 9.4A An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
- 9.4B Thus, an investor controls an investee if the investor has all of the following:
- (a) power over the investee;
 - (b) exposure, or rights, to variable returns from its involvement with the investee; and
 - (c) the ability to use its power over the investee to affect the amount of the investor's returns.
- 9.4C An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 9.4B.
- 9.5 Control is presumed to exist when the investor owns, directly or indirectly through subsidiaries, a majority of the voting rights of an investee. An investor that owns, directly or indirectly through subsidiaries, a majority of the voting rights of an investee is not required to assess whether it has the elements of control listed in paragraph 9.4B. However, the presumption can be rebutted if it can be clearly demonstrated that the investor does not have one or more of the elements of control listed in paragraph 9.4B—for example, if the investor owns a majority of the voting rights of an investee, but another entity has existing rights that give that entity the current ability to direct the **relevant activities** through contractual arrangements.

Educational notes

Assessing control

An entity is required to assess whether it controls an entity it has invested in, regardless of the nature of the investor's involvement with the investee. The investor assesses whether a parent–subsidiary relationship exists between itself and the investee. A subsidiary is an entity that is controlled by another entity.

Definition of control

Paragraph 9.4A sets out the definition of control, which is often referred to as ‘the control model’. This definition is the single basis an investor uses to assess whether it controls an investee.

Paragraph 9.4B sets out the elements of control, which an investor is required to have to control an investee. The elements of control are:

- power over the investee;
- exposure, or rights, to variable returns from the investor's involvement with the investee; and
- the ability of the investor to use its power over the investee to affect the amount of the investor's returns.

An investor considers all relevant facts and circumstances to determine whether it has control of an investee. If facts and circumstances indicate there are changes to the investor's elements of control as listed in paragraph 9.4B, an investor reassesses whether it controls an investee.

Rebuttable presumption

Paragraph 9.5 is a simplification of the control model and permits an entity to use a rebuttable presumption. An investor is permitted to presume it controls an investee if it owns (directly or indirectly through subsidiaries) a majority of the voting rights in the investee. An investor that owns more than 50% of the voting rights of an investee owns the majority of the voting rights of the investee.

The presumption in paragraph 9.5 can be rebutted if it can be clearly demonstrated that the investor does not control the investee (that is, the investor does not have one or more of the elements of control listed in paragraph 9.4B).

An investor that owns the majority of the voting rights in an investee might rebut the presumption in paragraph 9.5 in situations such as when:

- another entity has existing rights that give that entity the current ability to direct the relevant activities—for example through contractual arrangements. The other entity therefore has power over the investee.
- the relevant activities of the investee are directed by a government, court, administrator, receiver, liquidator or regulator, resulting in the investor not having power over the investee.
- the majority of the board members (or the governing body) are appointed by another entity and represent the interest of that other entity, so the investor cannot remove or appoint new directors and does not have power over the investee.

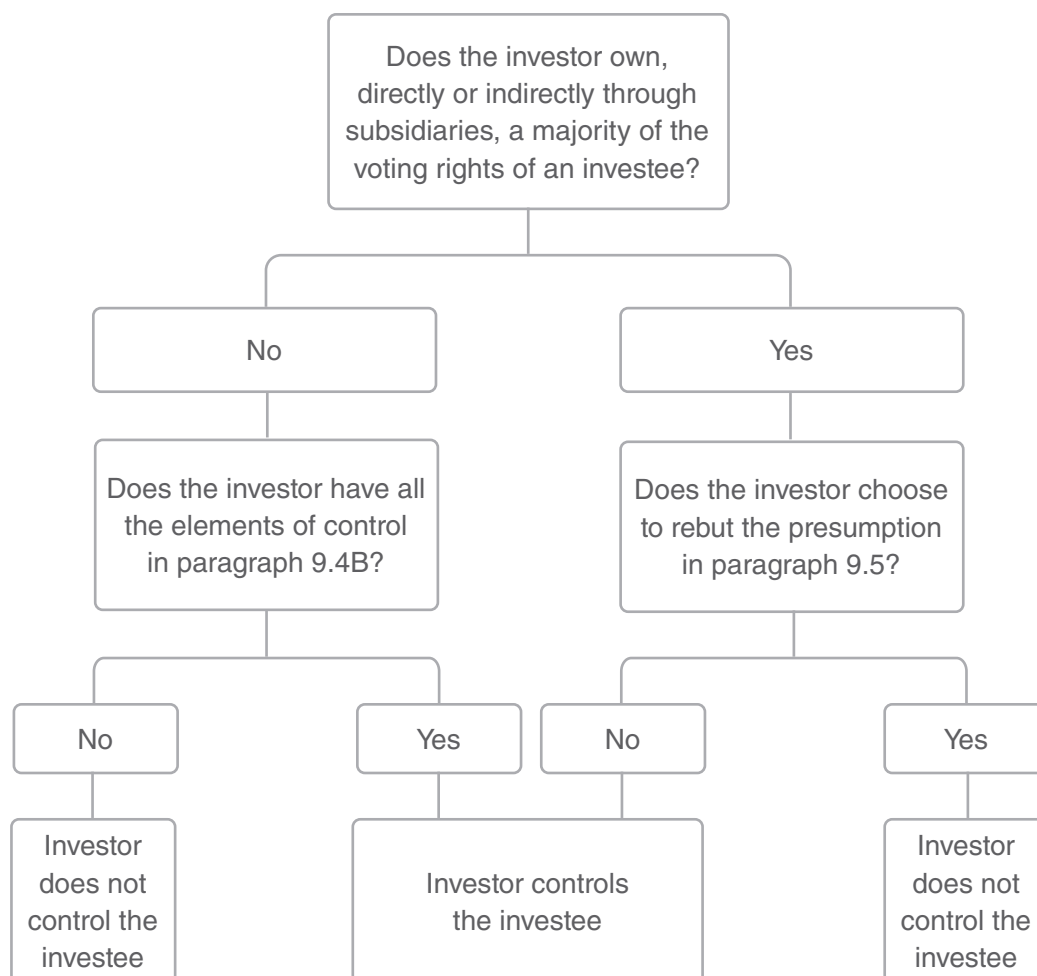
- another investor has a super voting right attached to a different class of shares and, consequently, has power over the investee.
- the investor receives a fixed return from the investee, regardless of the investee's performance.
Therefore, the investor is neither exposed, nor has rights, to variable returns from its involvement with the investee.

The rebuttable presumption in paragraph 9.5 only applies to an investor that owns a majority of the voting rights of an investee. An investor that does not own a majority of the voting rights of an investee cannot apply the rebuttable presumption. An investor that does not own a majority of the voting rights of an investee determines if it controls the investee by assessing if it has the elements of control listed in paragraph 9.4B.

Examples 12–13 show how an entity applies the rebuttable presumption. Examples 14–16 show how the presumption can be rebutted.

Figure 1 illustrates how an entity can assess if it controls an investee.

Figure 1—Decision tree: assessing control



Power

- 9.6 An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, that is, the activities that significantly affect the investee's returns. Depending on the circumstances, relevant activities can include:
- (a) selling and purchasing goods or services;
 - (b) selecting, acquiring or disposing of assets;
 - (c) researching and developing new products or processes; and
 - (d) determining a funding structure or obtaining funding.
- 9.7 An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but is not, in itself, conclusive in determining whether the investor has power over an investee.
- 9.7A If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.
- 9.7B An investor will typically have power when it holds a majority of the voting rights of an investee (see paragraph 9.5). However, an investor can have power even if it holds less than a majority of the voting rights of an investee, for example, through:
- (a) a contractual arrangement between the investor and other vote-holders;
 - (b) rights arising from other contractual arrangements;
 - (c) the investor's voting rights;
 - (d) potential voting rights (see paragraph 9.8); or
 - (e) a combination of (a)–(d).
- 9.8 When determining whether it has power, an investor considers its potential voting rights as well as potential voting rights held by other parties. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the holder of the right has the practical ability to exercise that right. Usually, for the holder of the right to have the practical ability to exercise that right, the right needs to be currently exercisable.
- 9.9 If an investor also has voting or other decision-making rights relating to the investee's relevant activities, the investor assesses whether those rights, in combination with potential voting rights, give the investor power.

Educational notes

To have power over an investee, an investor is required to have existing rights that give it the current ability to direct the relevant activities of the investee. The Glossary defines relevant activities as ‘the activities that significantly affect the investee’s returns’. If an investor has existing rights that give it the current ability to direct only those activities that are not the relevant activities of the investee, then the investor does not have power over the investee.

Determining whether an investor has power depends on the relevant activities, the way decisions about the relevant activities are made and the rights the investor and other parties have in relation to the investee. Paragraph 9.6 includes a list of examples of relevant activities. Examples of decisions about relevant activities include, but are not limited to decisions about:

- the investee’s operations and capital, including budgets; and
- the investee’s key employees (such as directors or management) or providers of key services and decisions such as appointing, remunerating and terminating their services or employment.

If two or more investors have existing rights that give them the unilateral ability (that is, the ability to act on their own) to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

Rights that give the investor power over the investee—Investor’s voting rights

Power arises from rights. Usually, an investor that holds a majority of the voting rights of an investee will have power over the investee if:

- the investor’s vote directs the investee’s relevant activities; or
- the investor appoints a majority of the members of the governing body that directs the investee’s relevant activities.

An investor with less than a majority of the voting rights can have rights that are sufficient to give it power if the investor has the practical ability to direct the relevant activities unilaterally (that is, to act on its own).

When assessing whether its voting rights are sufficient to give it power, an investor considers all facts and circumstances. Such facts and circumstances might include:

- the size of the investor’s holding of voting rights relative to the size and dispersion of holdings of the other vote-holders;
- potential voting rights held by the investor, other vote-holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders’ meetings.

Potential voting rights

When assessing control, an investor considers its potential voting rights and potential voting rights held by other parties to determine whether it has power. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options, including forward contracts. An investor considers potential voting rights only if it has the practical ability to exercise that right.

For example, an investor might own some share warrants in an investee, either alone or together with some ordinary shares in the investee. If the share warrants are ignored, the investor might not control the investee. However, upon exercise of the share warrants, the investor would control the investee. If exercising the share warrants would give the investor control of the investee, holding the warrants would give the investor the current ability to control the investee, but only if the warrants were currently exercisable.

Accordingly, the Standard requires an investor to consider the existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by another entity, when assessing whether the investor has power over an investee.

The existence of potential voting rights does not affect a parent's share in the net profit or loss of its subsidiary. The profit or loss (including each component of other comprehensive income when applicable) of the subsidiary as part of the consolidated profit or loss is attributed to the owners of the parent and to the non-controlling interest based on present ownership interest (see paragraph 9.14).

Practical ability to exercise rights

In assessing whether it has power, an investor considers only those rights it has the practical ability to exercise.

Entities are permitted to consider the requirements in full IFRS Accounting Standards in accordance with paragraph 10.6 of Section 10 *Accounting Policies, Estimates and Errors* of the Standard. In accordance with paragraph B23 of IFRS 10 *Consolidated Financial Statements*, an investor assessing whether it has the practical ability to exercise its rights can (but is not required to) consider:

- whether any barriers (economic or otherwise) exist that prevent the investor from exercising its rights. Examples of such barriers include potential financial losses if the investor exercises its rights and terms and conditions that make it unlikely that the investor would exercise its rights—for example, a conversion price that creates a financial barrier to exercising the rights.
- whether the investor would benefit from the exercise of its rights.

For the potential rights to give the investor the practical ability to exercise the rights, the rights need to be exercisable when decisions about the relevant activities need to be made.

Rights that give the investor power over the investee—Contractual arrangements

If voting rights cannot have a significant effect on an investee's returns, such as when the voting rights relate to administrative tasks only or contractual arrangements that determine the direction of the relevant activities, the investor assesses those contractual arrangements to determine whether it has rights that are sufficient to give it power over the investee.

Paragraph 9.7B provides examples of other rights that can give the investor power over the investee if the investor holds less than a majority of the voting rights.

A contractual arrangement between an investor and other vote-holders can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor does not have voting rights sufficient to give it power without the contractual arrangement. The contractual arrangement might ensure that the investor can direct enough other vote-holders on how to vote to enable the investor to make decisions about the relevant activities.

Other decision-making rights, in combination with voting rights, can give an investor the current ability to direct the relevant activities of an investee. For example, the rights specified in a contractual arrangement in combination with voting rights might be sufficient to give an investor the current ability to direct the manufacturing processes of an investee or to direct other activities of an investee that significantly affect the investee's returns. However, in the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee.

Practical assessment

Entities are permitted (but not required) to consider the requirements in full IFRS Accounting Standards in accordance with paragraph 10.6 of Section 10. In circumstances in which it might be difficult to determine whether an investor's rights are sufficient to give it power over an investee, the investor might apply paragraph B18 of IFRS 10 and consider evidence of whether it has the practical ability to direct the relevant activities of an investee unilaterally. An investor should consider several factors that provide evidence that the investor's rights are sufficient to give it power over the investee, including that:

- the investor, without having the contractual right to do so, is able to appoint or approve the key management personnel that manage the investee's operations, such as directors and management who have the ability to direct the relevant activities;
- the investee's key management personnel, such as directors and management, are related parties of the investor—for example, the financial director is the same person for both the investor and the investee; and
- the majority of the members of the investee's governing body are related parties of the investor, such as close family members.

Sometimes there will be indications that the investor has a special relationship with the investee, which suggests that the investor has more than a passive interest in the investee. The existence of any indicator, or a combination of indicators, does not necessarily mean that the investor has power over the investee. However, having more than a passive interest in the investee might indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee. For example, the investor might have more than a passive interest in the investee and, in combination with other rights, might have power over it if:

- the investee's key management personnel, such as directors or management, who have the ability to direct the relevant activities are current or previous employees of the investor;

- the investee's operations are dependent on the investor—for example, if:
 - the investor provides most of the funding of the investee's operations;
 - the investor guarantees a significant portion of the investee's obligations; or
 - the investee depends on the investor for key employees, such as those with specialised knowledge of the investee's operations; or
- a significant portion of the investee's activities are conducted on behalf of the investor.

Returns

- 9.10 An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

Educational notes

When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee. Examples of returns include:

- dividends.
- other distributions of economic benefits from an investee.
- changes in the value of the investor's investment in that investee.
- returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets.

Link between power and returns

- 9.11 For an investor to control an investee, the investor must have not only power over the investee and exposure or rights to variable returns from its involvement with the investee, but also the ability to use its power to affect its returns from its involvement with the investee.
- 9.12 When an investor with decision-making rights (a decision-maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf, and for the benefit, of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority. Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision-maker is not an agent simply because other parties can benefit from the decisions that it makes.

Educational notes

In addition to power and exposure or rights to variable returns from its involvement with the investee, an investor is required to be able to use its power to affect its returns from its involvement with the investee.

Delegated power—Agents

When an investor with decision-making rights assesses whether it controls an investee, it determines whether it is a principal or an agent. An investor also determines whether another entity with decision-making rights is acting as an agent for the investor.

An investor might delegate its decision-making authority to an agent on some specific matters or on all relevant activities. When assessing whether it controls an investee, the investor treats the decision-making rights delegated to its agent as held by the investor directly. In situations in which there is more than one principal, each of the principals assesses whether it has power.

The examples illustrating how to assess control are as follows:

Topic	Example(s)
Applying the rebuttable presumption	12–13
Rebutting the presumption in paragraph 9.5	14–16
Relevant activities directed by two investors	17
Holding less than a majority of voting rights	18–19
Potential voting rights	20–21
Agency	22–23

Examples—Assessing control: Applying the rebuttable presumption

Ex 12 SME A owns all of the ordinary shares of SME B, to which voting rights are attached. All ordinary shares in SME B carry equal voting rights.

SME A directly owns 100% of the voting rights of SME B. Applying the rebuttable presumption in paragraph 9.5, SME A is presumed to control SME B. That is, SME A is the parent of SME B.¹

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

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- Ex 13** SME A owns 60% of the ordinary shares of SME B, to which voting rights are attached. SME B owns 70% of the ordinary shares of SME C, to which voting rights are attached. All ordinary shares in SMEs B and C carry equal voting rights.

SME B directly owns 70% of the voting rights of SME C. Applying the rebuttable presumption in paragraph 9.5, SME B controls SME C. That is, SME B is the parent of SME C.

SME A directly owns 60% of the voting rights of SME B and indirectly owns a majority of the voting rights of SME C through its subsidiary, SME B. Applying the rebuttable presumption in paragraph 9.5, SME A controls SMEs B and C. That is, SME A is the parent of SME B and the ultimate parent of SME C. SMEs B and C are subsidiaries of SME A.

Examples—Assessing control: Rebutting the presumption in paragraph 9.5

- Ex 14** SME A owns 60% of the ordinary shares of SME B, to which voting rights are attached. SME C owns the remaining 40% of the ordinary shares of SME B, to which voting rights are attached. SME C has a contractual arrangement with SME A that gives SME C the exclusive right to direct the key decisions of SME B relating to operations and finance, which are the relevant activities.

SME A owns a majority of the voting rights of SME B, but does not have one of the elements of control in paragraph 9.4B: power. SME A does not have power over SME B because SME C has the current ability to direct the relevant activities of SME B through the contractual arrangement. Therefore, the presumption in paragraph 9.5 can be rebutted. SME A rebuts the presumption and concludes that it does not control SME B, even though SME A owns a majority of the voting rights of SME B.

- Ex 15** SME A owns 60% of the ordinary shares of SME B, to which voting rights are attached. SME C owns 40% of the ordinary shares of SME B, to which voting rights are attached. SME C has a contractual arrangement with SME A that gives SME C the exclusive right to appoint and remove the board of directors of SME B. The board of directors make decisions about the relevant activities of SME B.

SME A owns a majority of the voting rights of SME B. Applying the rebuttable presumption in paragraph 9.5, SME A is presumed to control SME B. This presumption can be rebutted if it can be clearly demonstrated that SME A does not have one or more of the elements of control listed in paragraph 9.4B.

SME A rebuts the presumption by demonstrating it does not have power over SME B because SME C has the current ability to direct the relevant activities by having the exclusive right to appoint and remove the board of directors of SME B through the contractual arrangement. This contractual arrangement results in SME A not having one of the elements of control listed in paragraph 9.4B: power.

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- Ex 16** SME A owns 65% of the ordinary shares of SME B, to which voting rights are attached. SME B has been placed under administration due to significant financial difficulties and a third-party entity has been appointed by the court to manage SME B's relevant activities.

SME A owns a majority of the voting rights of SME B. Applying the rebuttable presumption in paragraph 9.5, SME A is presumed to control SME B. This presumption can be rebutted if it can be clearly demonstrated that SME A does not have one or more of the elements of control listed in paragraph 9.4B.

SME A rebuts the presumption by demonstrating it does not have power over SME B because the third-party administrator has the current ability to direct the relevant activities of SME B.

Example—Assessing control: Relevant activities directed by two investors

- Ex 17** SMEs A and B each own 50% of the ordinary shares of SME C, to which voting rights are attached. SME C sells toys. SME A has the right to direct the selling and purchasing activities of SME C. SME B has the right to direct the activities related to research and development of new toys. The selling and purchasing activities most significantly affect the returns of SME C.

SMEs A and B each have existing rights that give them the unilateral ability to direct different relevant activities of SME C. The investor that has the current ability to direct the activities that most significantly affects the returns of SME C is SME A. SME A directs the selling and purchasing activities, which are most significant in affecting the returns of SME C.

Therefore, SME A has power over SME C and determines that it controls SME C. SME A is the parent of SME C.

Examples—Assessing control: Holding less than a majority of voting rights

- Ex 18** SME A owns 40% of the ordinary shares of SME B, to which voting rights are attached. The government of the jurisdiction in which SMEs A and B are registered and operate has granted SME A the sole right to determine the financial and operating policies of SME B, which are its relevant activities.

Although SME A owns less than a majority of the voting rights of SME B, SME A has power over SME B because it has the current ability to direct the relevant activities of SME B.

SME A determines that it controls SME B. SME A is the parent of SME B.

- Ex 19** SME A owns 45% of the ordinary shares of SME B, to which voting rights are attached. SME A also has the right to appoint the majority of the members of SME B's board of directors by applying special rights given to SME A in the founding document of SME B. The board of directors makes decisions about SME B's relevant activities.

Although SME A owns less than a majority of the voting rights of SME B, SME A has power over SME B because SME A has the right to appoint the majority of the members of the board of directors, which gives it the current ability to direct SME B's relevant activities.

SME A determines it controls SME B. SME A is the parent of SME B.

Examples—Assessing control: Potential voting rights

- Ex 20** SME A owns 30% of the ordinary shares of SME B, to which voting rights are attached. SME A also holds currently exercisable options to acquire shares in SME B that, if exercised, would increase SME A's voting rights in SME B to 70%. The relevant activities of SME B are directed by a majority vote.

SME A considers the potential rights in determining whether it has power over SME B because the potential rights are currently exercisable. That is, SME A has the practical ability to exercise the potential rights. SME A has the current ability to own a majority of the voting rights of SME B. SME A therefore has the current ability to direct the relevant activities of SME B.

SME A determines it has power and controls SME B. SME A is the parent of SME B.

- Ex 21** SME A owns 55%, SME B owns 20% and SME C owns 25% of the ordinary shares of SME D, to which voting rights are attached. SMEs B and C are independent third parties. SME B also holds currently exercisable share warrants in SME D that, if exercised, would increase SME B's voting rights in SME D to 60% and would reduce SME A's holding to 27.5% and SME C's to 12.5%. The relevant activities of SME D are directed by a majority vote.

SME B considers the potential voting rights in determining whether it has power over SME D because the potential rights are currently exercisable. That is, SME B has the practical ability to exercise the potential rights. SME B determines it has the current ability to own a majority of the voting rights of SME D. SME B therefore has the current ability to direct the relevant activities of SME D.

SME B has power and controls SME D. SME B is the parent of SME D.

Examples—Assessing control: Agency

- Ex 22** SME A holds 90% of the ordinary shares of SME B, to which voting rights are attached. SME A holds the ordinary shares as a decision-maker on behalf of SME L, a separate entity owned and managed by Mr X. SME A only receives an administrative fee from SME L for its services.

SME A first assesses whether it is acting as a principal or an agent. An agent is a party primarily engaged to act on behalf of, and for the benefit of, another party and therefore does not control the investee.

SME A is acting as an agent on behalf of SME L, and the fact that it receives an administration fee only means there is no link between power and returns and therefore SME A does not control SME B.

Ex 23 SME C holds 85% of the ordinary shares of SME D, to which voting rights are attached. SME C is acting as a nominee shareholder on behalf of SME E. SME E retains all rights to the returns from SME D and makes all strategic decisions through a formal agreement with SME C.

SME C's role is limited to executing decisions made by SME E and performing administrative tasks. SME C receives a fixed fee for its services and does not share in SME D's profits or losses.

SME C first assesses whether it is acting as a principal or an agent.

SME C is acting as an agent on behalf of SME E, and the fact that it receives a fixed fee only means there is no link between power and returns and therefore SME C does not control SME D.

Consolidation procedures

- 9.13 The consolidated financial statements present financial information about the **group** as a single economic entity. In preparing consolidated financial statements, an entity shall:
- (a) combine the **financial statements** of the parent and its subsidiaries line by line by adding together like items of assets, **liabilities, equity, income and expenses**.
 - (b) eliminate the **carrying amount** of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary.
 - (c) measure and present **non-controlling interest** in the **profit or loss** and **total comprehensive income** of consolidated subsidiaries for the **reporting period** separately from the interest of the **owners** of the parent.
 - (d) measure and present non-controlling interest in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them. Non-controlling interest in the net assets consists of:
 - (i) the amount of the non-controlling interest at the date of the original combination calculated in accordance with Section 19 *Business Combinations and Goodwill*; and
 - (ii) the non-controlling interest's share of changes in equity since the date of the combination.

Examples—Consolidation procedures

Ex 24 On 31 December 20X0, SME A acquired 100% of the ordinary shares of SME B, which carry voting rights at a general meeting of shareholders, for CU6,000 in cash.² It controlled SME B from that date. The acquisition date statements of financial position of SMEs A and B and the fair values of the assets and liabilities recognised on SME B's statement of financial position were:³

	SME A	SME B	
	<i>Carrying amount</i>	<i>Carrying amount</i>	<i>Fair value</i>
	<i>CU</i>	<i>CU</i>	<i>CU</i>
Assets			
Non-current assets			
Building and other property, plant and equipment (PPE)	7,000	3,000	3,300
Investment in SME B	6,000	–	–
	<u>13,000</u>	<u>3,000</u>	<u>–</u>
Current assets			
Inventories	700	500	600
Trade receivables	300	250	250
Cash	1,500	700	700
	<u>2,500</u>	<u>1,450</u>	<u>–</u>
Total assets	<u>15,500</u>	<u>4,450</u>	<u>–</u>
Equity and liabilities			
Equity			
Share capital	5,000	2,000	–
Retained earnings	10,200	2,300	–
	<u>15,200</u>	<u>4,300</u>	<u>–</u>
Current liabilities			
Trade payables	300	150	150
	<u>300</u>	<u>150</u>	<u>–</u>
Total liabilities and equity	<u>15,500</u>	<u>4,450</u>	<u>–</u>

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

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

SME A's consolidated statement of financial position at 31 December 20X0 is calculated as follows:

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

Consolidation involves:

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

The consolidation adjustments required for preparing the consolidated financial statements at 31 December 20X0 (presented in Column D) are:

<i>Consolidation adjustments</i>	<i>CU</i>	<i>CU</i>
Dr Asset—goodwill	1,300 ^(a)	
Dr Asset—buildings and other PPE	300	
Dr Asset—inventories	100	
Dr Equity—share capital (SME B)	2,000	
Dr Equity—retained earnings (SME B)	2,300	
Cr Asset—investment in SME B (SME A)		6,000

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

^(a) Working for goodwill:

Consideration transferred for the business combination	CU6,000
Fair value of identifiable net assets acquired	
acquisition date fair value of assets of SME B (buildings and other PPE (CU3,300) + inventories (CU600) + trade receivables (CU250) + cash (CU700)) – fair value of trade payables (CU150)	CU4,700
Goodwill	<u>CU1,300</u>

Ex 25 The facts are the same as in Example 24. At 31 December 20X1, one year after SME A acquired SME B, the individual statements of financial position and statements of comprehensive income of SMEs A and B are:

Statements of financial position at 31 December 20X1:

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

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

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

Note: Management's best estimate of the useful life of the goodwill is 10 years. SME A uses the straight-line amortisation method for goodwill. The fair value adjustment to buildings and other PPE is in respect to a building; all buildings have an estimated remaining useful life of 20 years from 31 December 20X0 and estimated residual values of nil. SME A uses the straight-line method for depreciation of PPE. All of the inventory held by SME B at 31 December 20X0 was sold to a third party during 20X1.

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

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

^(a) Cost of sales adjustment:

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

^(b) Administrative expenses adjustment:

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

Consolidation involves:

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

SME A's consolidated statement of financial position at 31 December 20X1 is computed as follows:

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

(c) Working for goodwill:

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

(d) Working for building consolidation adjustment:

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

(e) Reserves adjustment:

Adjustment at the acquisition date (CU2,300) (see Example 24) + amortisation of goodwill (CU130^(c)) + additional depreciation on building (CU15^(d)) + fair value adjustment in respect of inventories (CU100^(a)) = CU2,545.

Consolidation involves:

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

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

1. Repeat of acquisition date consolidation adjustment:

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

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

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

	CU	CU
Dr Equity—profit or loss 20X1—administrative expenses	145	
Cr Asset—goodwill		130 ^(c)
Cr Asset—buildings and other PPE		15 ^(d)

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

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

	CU	CU
Dr Equity—profit or loss 20X1—cost of sales	100	
Cr Asset—inventories		100

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

Educational notes

The Glossary defines non-controlling interest (NCI) as 'the equity in a subsidiary not attributable, directly or indirectly, to a parent'. At the acquisition date, the NCI in a subsidiary is measured at the NCI's proportionate share of the recognised amounts of the subsidiary's identifiable net assets (excluding goodwill), in accordance with Section 19 *Business Combinations and Goodwill* of the Standard.

At the parent's reporting date, the NCI in a subsidiary is measured at the NCI's proportionate share of the amount of the subsidiary's identifiable net assets recognised at acquisition plus (or minus) any post-acquisition change in the subsidiary's net assets recognised in the consolidated financial statements.

Examples—Non-controlling interest

Ex 26 SME A acquired 90% of the share capital of SME B at 1 January 20X1 and controlled SME B from that date. The group financial statements are being prepared for the year ended 31 December 20X4. The carrying amount of SME B's identifiable net assets in the consolidated financial statements during 20X4 do not change from the following information:

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

No transactions occurred between SMEs A and B from 20X1 to 20X4. The ownership interest of SME A has not changed.

NCI could be calculated as follows:

	CU
1. NCI's proportionate share of the acquisition date fair values of SME B's identifiable net assets ($10\% \times \text{CU}1,000$).	100
2. NCI's proportionate share of the change in the carrying amounts of the net assets (or equity) of the subsidiary (SME B) in the consolidated financial statements from the acquisition date to 31 December 20X3 ($10\% \times \text{CU}5,000$).	500
3. NCI's proportionate share of the current period increase in the carrying amounts of the net assets (or equity) of the subsidiary (SME B) in the consolidated financial statements. In this example, the increase relates solely to the amount of consolidated profit for 20X4 attributable to SME B ($10\% \times \text{CU}500$).	50
Total	<u>650</u>

Alternatively, NCI can be calculated as: $10\% \times \text{carrying amount of SME B's identifiable net assets in the consolidated statement of financial position at 31 December 20X4 (CU6,500)} = \text{CU650}$.

Ex 27 On 31 December 20X0, SME A acquired 75% of the ordinary shares of SME B, which carry voting rights at a general meeting of shareholders, for CU4,500 in cash. It controlled SME B from that date. The acquisition-date statements of financial position of SMEs A and B and the fair values of the assets and liabilities recognised on SME B's statement of financial position were:

	SME A	SME B	
	<i>Carrying amount</i>	<i>Carrying amount</i>	<i>Fair value</i>
	<i>CU</i>	<i>CU</i>	<i>CU</i>
Assets			
Non-current assets			
Buildings and other property, plant and equipment (PPE)	7,000	3,000	3,300
Investment in SME B	6,000	–	–
	<u>13,000</u>	<u>3,000</u>	<u>–</u>
Current assets			
Inventories	700	500	600
Trade receivables	300	250	250
Cash	1,500	700	700
	<u>2,500</u>	<u>1,450</u>	<u>–</u>
Total assets	<u>15,500</u>	<u>4,450</u>	<u>–</u>
Equity and liabilities			
Equity			
Share capital	5,000	2,000	–
Retained earnings	10,200	2,300	–
	<u>15,200</u>	<u>4,300</u>	<u>–</u>
Current liabilities			
Trade payables	300	150	150
	<u>300</u>	<u>150</u>	<u>–</u>
Total liabilities and equity	<u>15,500</u>	<u>4,450</u>	<u>–</u>

In this example, the consolidated statement of financial position is being prepared as at the date of acquisition. In order to calculate the NCI as at the date of acquisition, it is only necessary to perform the calculation in paragraph 9.13(d)(i).

Thus, NCI is calculated as: $25\% \times \text{SME B's identifiable net assets at fair value (CU4,700)} = \text{CU1,175}$. (See footnote (a) to Example 24 for the calculation of SME B's acquisition-date identifiable net assets at fair value.)

SME A's consolidated statement of financial position at 31 December 20X0 is calculated as follows:

	SME A <i>Carrying amount</i>	SME B <i>Carrying amount</i>	Consolidation adjustments	Consolidated
	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>
Assets				
Non-current assets				
Goodwill	—	—	975 ^(a)	975
Buildings and other PPE	7,000	7,000	300	10,300
Investment in SME B	4,500	4,500	(4,500)	—
	<u>11,500</u>	<u>11,500</u>		<u>11,275</u>
Current assets				
Inventories	700	500	100	1,300
Trade receivables	300	250		550
Cash	3,000	700		3,700
	<u>4,000</u>	<u>1,450</u>		<u>5,550</u>
Total assets	<u>15,500</u>	<u>4,450</u>		<u>16,825</u>

Equity and liabilities**Equity attributable to owners of parent**

Share capital	5,000	2,000	(2,000)	5,000
Retained earnings	10,200	2,300	(2,300)	10,200
	<u>15,200</u>	<u>4,300</u>		<u>15,200</u>

Non-controlling interest	<u>—</u>	<u>—</u>	1,175	<u>1,175</u>
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Total equity	<u>15,200</u>	<u>4,300</u>		<u>16,375</u>
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Current liabilities

Trade payables	300	150		450
	<u>300</u>	<u>150</u>		<u>450</u>

Total liabilities and equity	<u>15,500</u>	<u>4,450</u>		<u>16,825</u>
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Consolidation involves:

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

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

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

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

^(a) Working for goodwill:

Consideration transferred for the business combination	CU4,500
Fair value of identifiable net assets acquired (75% × CU4,700)	CU3,525
Goodwill	<u>CU975</u>

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

Ex 28 The facts are the same as in Example 27. At 31 December 20X1, one year after SME A acquired SME B, the individual statements of financial position and statements of comprehensive income of SMEs A and B are:

Statements of financial position at 31 December 20X1:

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

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

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

Note: Management's best estimate of the useful life of the goodwill is 10 years. SME A uses the straight-line amortisation method for goodwill. The fair value adjustment to buildings and other PPE is in respect to a building. All buildings have an estimated remaining useful life of 20 years from 31 December 20X0 and estimated residual values of nil. SME A uses the straight-line method for depreciation of PPE. All of the inventory held by SME B at 31 December 20X0 was sold to a third party during 20X1.

The NCI's proportion of SME B is 25% and the NCI's ownership interest since the acquisition of SME A did not change.

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

NCI at date of acquisition (31 December 20X0) (see Example 27)	CU1,175
NCI's share of profit for the year ended 31 December 20X1 (25% × [profit of SME B per SME B's financial statements (CU550) – group inventory fair value adjustment (CU100) – group depreciation on building fair value adjustment (CU15)])	CU109
As at 31 December 20X1	CU1,284

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

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

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

	SME A	SME B	Consolidation adjustments	Consolidated
	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>
Revenue	3,000	1,900		4,900
Cost of sales	(1,800)	(1,000)	(100) ^(a)	(2,900)
Gross profit	1,200	900		2,000
Administrative expenses	(400)	(350)	(113) ^(b)	(863)
Profit for the year	800	550		1,137

Profit attributable to:

Owners of the parent	1,028
Non-controlling interest	109
	<u>1,137</u>

Consolidation involves:

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

SME A's consolidated statement of financial position at 31 December 20X1 is computed as follows:

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

Consolidation involves:

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

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

1. Repeat of acquisition date consolidation adjustment:

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

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

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

		CU	CU
Dr	Equity—profit or loss 20X1—administrative expenses	113	
	Cr Asset—goodwill		98 ^(c)
	Cr Asset—buildings and other PPE		15 ^(d)

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

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

		CU	CU
Dr	Equity—profit or loss 20X1—cost of sales*	100	
	Cr Asset—inventories		100

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

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

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

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

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

^(a) Cost of sales adjustment:

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

^(b) Administrative expenses adjustment:

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

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

^(c) Working for goodwill:

Goodwill at the acquisition date (CU975) – accumulated amortisation, which this year is amortisation for one year (CU975 × 1/10 years) = CU877.

^(d) Working for building consolidation adjustment:

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

^(e) Reserves adjustment:

Adjustment at the acquisition date (CU2,300) (see Example 27) + amortisation of goodwill (CU98^(c)) + additional depreciation on building (CU15^(d)) + fair value adjustment in respect of inventories (CU100(a)) + NCI's share of SME B's profit for the year, as included in the consolidated statement of comprehensive income (CU109) = CU2,622.

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

Educational notes

It is important to understand the difference between determining control and attributing profits. Control is determined based on the requirements in paragraphs 9.4B–9.12. In determining whether an investor has power over an investee, an entity considers potential voting rights that are currently exercisable (see paragraph 9.8). In contrast, in attributing profits and calculating the NCI in the net assets, an entity considers only existing ownership interests and not potential ownership interests. A parent is normally only entitled to the returns from its subsidiary based on its existing ownership interest. For example, a parent receives dividends based on its existing ownership interest in the subsidiary.

Examples—Allocation of profit or loss and changes in equity

Ex 29 SMEs A and B (which are unrelated) own 90% and 10% respectively of the ordinary shares of SME C, which carry voting rights at a general meeting of shareholders. SME A sells an option to SME D to buy one-third of its interest in SME C. The option is exercisable at any time and, if exercised, it would give SME D 30% of the ownership interest and voting rights in SME C.

The existence of the option would be considered in determining control because the option is currently exercisable. That is, SME D has the practical ability to exercise the option. In this example, the effect of exercising the option would be to reduce SME A's ownership interest in SME C from 90% to 60%. Applying the rebuttable presumption in paragraph 9.5, SME A still controls SME C because it controls 60% (a majority) of the voting rights in SME C (direct ownership of 90% minus SME D's currently exercisable option for 30% of SME C).

The proportions of profit or loss and changes in equity allocated to the parent and NCI are determined on the basis of existing ownership interests (90% for SME A and 10% for SME B). Possible exercise or conversion of the option is not reflected in the calculation of the NCI in the profit and net assets of SME C. SME A accounts for the option applying Section 11 *Financial Instruments* of the Standard.

Ex 30 SME A owns 40% of the ordinary shares of SME B, which carry voting rights at a general meeting of shareholders. SME A also owns an option which, if exercised, would give SME A a further 20% ownership interest in SME B. The option is currently exercisable.

Applying the rebuttable presumption in paragraph 9.5, SME A controls SME B because it controls a majority of the voting rights of SME B (direct ownership of 40% and a currently exercisable option to acquire a further 20%). Consequently, SME B is a subsidiary of SME A.

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

Intragroup balances and transactions

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

Educational notes

Intragroup transactions that entities might enter into include sales and purchases of goods and services, dividend distributions and financing. Entities are required to account for such transactions in their individual financial statements as if they were transactions between entities outside the group.

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

If the individual financial statements of entities are simply added together without any adjustment, the consolidated financial statements would include the results from transactions with parties external to the group and the results of transactions within the group. In the example in the previous paragraph, if the individual financial statements are simply added together, the sale of the inventory would be recorded, but if the subsidiary had not sold the inventory by the year-end, the inventory would simply have been moved from one part of the group to another. Consolidated financial statements aim to present the assets, liabilities, equity, income, expenses and cash flows of the group (a parent and its subsidiaries) as those of a single entity. Consequently, the effects of transactions within the group—that is, transactions between the parent and its subsidiaries—are required to be adjusted (eliminated) in the preparation of the consolidated financial statements. By adjusting the effects of intragroup transactions, the consolidated financial statements will present transactions with parties outside the group only.

Examples—Inventory

Ex 31 SME A controls SME B. On 30 December 20X1, SME A purchased inventory from SME B for CU1,000. The cost to SME B of the inventory is CU800. Consequently, the following journal entries were made in the individual accounting records of SMEs A and B (and next to these entries are the entries that would have been made in the group's accounting records if the group maintained a general ledger):⁴

		Individual entity accounting records		Group accounting records	
		CU	CU	CU	CU
SME B					
Dr	Asset—inventory	800		800	
	Cr Asset—cash		800		800
<i>To recognise the purchase of inventory from a third party.</i>					
Dr	Asset—cash	1,000			
	Cr Income—revenue		1,000		
Dr	Expense—cost of sales	800			
	Cr Asset—inventory		800		
<i>To recognise the sale of inventory to SME A.</i>					
SME A					
Dr	Asset—inventory	1,000			
	Cr Asset—cash		1,000		
<i>To recognise the purchase of inventory for cash from SME B.</i>					

⁴ From the perspective of the group, there is no sale of inventory. Consequently, if a general ledger were maintained for the group (instead of separate general ledgers for the parent and the subsidiary), the sale of inventory by SME B to SME A would not result in any entry being recorded in the group's general ledger.

At 31 December (the end of the group's annual reporting period), SME A had not sold any of the inventory it purchased from SME B to parties outside the group.

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

		CU	CU
Dr	Income—revenue	1,000	
	Cr Expense—cost of sales		800
	Cr Asset—inventory		200

To eliminate the effects of the intragroup transaction.

The adjustment eliminates the effect of the intragroup sale of inventory. From the group's perspective, no sale is recognised in the consolidated financial statements because these financial statements present a single reporting entity.

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

If SME A owns 80% of the share capital of SME B and SME A sold the inventory to SME B, the allocation to the NCI would not be adjusted because the profit to be eliminated when preparing the consolidated financial statements would be made by SME A, not SME B, and the NCI of SME B is not entitled to share in the profits of SME A.

Ex 32 The facts are the same as in Example 31. However, in this example, income tax is not ignored. Assume a tax rate of 20% is applicable to both SMEs A and B.

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

		CU	CU
Dr	Income—revenue	1,000	
	Cr Expense—cost of sales		800
	Cr Asset—inventory		200
Dr	Asset—deferred tax	40	
	Cr Income—income tax: deferred tax		40

To eliminate the effects of the intragroup transaction.

On consolidation, a tax-effect adjustment is necessary because the first part of the adjustment decreases the carrying amount of inventory from CU1,000 (in the individual records of SME A) to CU800 in the consolidated financial statements without a corresponding decrease in the tax base of the inventory (assuming the tax authorities do not make a corresponding adjustment for the purpose of determining taxable income). The CU200 difference is a deductible temporary difference (see Section 29 *Income Tax* of the Standard) that gives rise to a deferred tax asset of CU40 ($20\% \times \text{CU}200$) and a corresponding decrease in income tax expense. If the inventory is sold by the group to a third party, this temporary difference reverses and the respective tax expense is recognised.

Ex 33 SME A owns all of the share capital of SME B and consequently controls it. On 1 January 20X1, SME A purchased inventory from SME B for CU1,000. The cost of the inventory to SME B was CU800. On 2 February 20X1, SME A sells the inventory to a party outside the group for CU1,500. Assume a tax rate of 20% is applicable for both SMEs A and B.

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

		Individual entity accounting records		Group accounting records	
		CU	CU	CU	CU
SME B					
Dr	Asset—inventory	800		800	
	Cr Asset—cash		800		800
<i>To recognise the purchase of inventory.</i>					
Dr	Asset—cash	1,000			
	Cr Income—revenue		1,000		
Dr	Expense—cost of sales	800			
	Cr Asset—inventory		800		
<i>To recognise the sale of inventory.</i>					
SME A					
Dr	Asset—inventory	1,000			
	Cr Asset—cash		1,000		
<i>To recognise the purchase of inventory for cash from SME B.</i>					

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

		Individual entity accounting records		Group accounting records	
		CU	CU	CU	CU
SME A					
Dr	Asset—cash	1,500		1,500	
	Cr Income—revenue		1,500		1,500
Dr	Expense—cost of sales	1,000		800	
	Cr Asset—inventory		1,000		800

To recognise the sale of inventory.

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

		Individual entity accounting records		Group accounting records	
		CU	CU	CU	CU
SME B					
Dr	Expense—income tax: current tax	40		40	
	Cr Liability—current tax		40		40

To recognise the obligation to pay income tax on the sale of inventory.

		SME A			
Dr	Expense—income tax: current tax	100		100	
	Cr Liability—current tax		100		100

To recognise the obligation to pay income tax on the sale of inventory.

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

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

Elimination of the effects of the intragroup transaction.

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

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

Ex 34 SME A owns all of the share capital of SME B and consequently controls it. On 1 November 20X1, SME A purchased inventory from SME B for CU1,000. The cost of the inventory to SME B was CU800. By the end of the period, SME A had sold half of the inventory to a party outside the group for CU750. Assume a tax rate of 20% is applicable to both SMEs A and B.

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

		Individual entity accounting records		Group accounting records	
		CU	CU	CU	CU
SME B					
Dr	Asset—inventory	800		800	
	Cr Asset—cash		800		800
<i>To recognise the purchase of inventory.</i>					
Dr	Asset—cash	1,000			
	Cr Income—revenue		1,000		
Dr	Expense—cost of sales	800			
	Cr Asset—inventory		800		
<i>To recognise the sale of inventory to SME A.</i>					
SME A					
Dr	Asset—inventory	1,000			
	Cr Asset—cash		1,000		
<i>To recognise the purchase of inventory for cash from SME B.</i>					
Dr	Asset—cash	750		750	
	Cr Income—revenue		750		750
Dr	Expense—cost of sales	500		400	
	Cr Asset—inventory		500		400
<i>To recognise the sale of inventory.</i>					

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

		Individual entity accounting records		Group accounting records	
		CU	CU	CU	CU
SME B					
Dr	Expense—income tax: current tax	40		40	
	Cr Liability—current tax		40		40
Dr	Asset—deferred tax			20	
	Cr Income—income tax: deferred tax				20

To recognise the obligation to pay income tax on the sale of inventory.

SME A					
Dr	Expense—income tax: current tax	50		50	
	Cr Liability—current tax		50		50

To recognise the obligation to pay income tax on the sale of inventory.

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

		CU	CU
Dr	Income—revenue	1,000	
	Cr Expense—cost of sales		900
	Cr Asset—inventory		100
Dr	Asset—deferred tax	20	
	Cr Income—income tax: deferred tax		20

To eliminate the effects of the intragroup transaction.

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

The aggregated cost of sales recorded by SMEs A and B is CU1,300 (SME A's cost of sales (CU500) + SME B's cost of sales (CU800)). However, the group's cost of sales is only CU400 (50% × the cost of the inventory the group sold to the party outside the group (CU800)).

The CU100 adjustment to inventory reflects that portion of the total profit on sale of the transferred inventory that remains as inventory on hand at the end of the period. Because 50% of the transferred inventory is still on hand at the end of the period, 50% of the total profit on the intragroup transfer of inventory ($50\% \times \text{CU}200$) is eliminated at the end of the period.

Although the carrying amount of inventory in the individual records of SME A (CU500) and in the consolidated financial statements (CU400) have a difference of CU100, the tax base of the inventory in both the consolidated and separate entity financial statements is CU500 (assuming the tax authorities do not make a corresponding adjustment for the purpose of determining taxable income). Consequently, there is a CU100 deductible temporary difference that gives rise to a deferred tax asset of CU20 ($20\% \times \text{CU}100$) in the consolidated statement of financial position and a corresponding effect in equity (the income tax expense component of profit or loss for the year ended 31 December 20X1).

Ex 35 The facts are the same as in Example 34. Consequently, on the first day of its next accounting period, 1 January 20X2, SME A has inventory with a carrying amount of CU500, which it purchased from SME B in 20X1. The inventory cost SME B CU400.

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

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

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

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

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

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

Examples—Property, plant and equipment

Ex 36 SME A owns all the share capital of SME B and, consequently, controls SME B. On 31 December 20X2, SME A purchased a plot of land from SME B on which the group plans to construct a building for its new headquarters. The carrying amount of the land in SME B's individual accounting records was CU1,000 and the selling price is CU1,100.

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

		Individual entity accounting records		Group accounting records	
		CU	CU	CU	CU
SME B					
Dr	Asset—property, plant and equipment (PPE)	1,000		1,000	
	Cr Asset—cash		1,000		1,000
<i>To recognise the purchase of land for cash.</i>					
Dr	Asset—cash	1,100			
	Cr Asset—PPE		1,000		
	Cr Income—profit on sale of PPE		100		
<i>To recognise the sale of land for cash.</i>					
SME A					
Dr	Asset—PPE	1,100			
	Cr Asset—cash		1,100		
<i>To recognise the purchase of land for cash from SME B.</i>					

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

		CU	CU
Dr	Income—profit on sale of PPE	100	
	Cr Asset—PPE		100
<i>Elimination of the effects of the intragroup sale of land.</i>			

These consolidation adjustments ‘reduce’ the carrying amount of the land from CU1,100 in the individual records of SME A to CU1,000 in the consolidated financial statements (the cost to the group). The consolidation adjustment eliminates the effect of the intragroup transaction (a CU100 ‘increase’ in the carrying amount of land and the profit (CU100) recognised in SME B’s individual financial statements for the disposal of land).

Ex 37 SME A owns all the share capital of SME B and, consequently, controls SME B. On 1 January 20X2, SME A purchased a building from SME B for CU600. The group plans to use the building as its new head office. SME B had purchased the building from a third party on 1 January 20X1 for CU525. At the time, the building was assessed to have a useful life of 21 years and a residual value of nil. On 1 January 20X2, the carrying amount of the building was CU500 in SME B’s individual accounting records. The estimated remaining useful life of the building measured from 1 January 20X2 is 20 years and the residual value of the building is still nil. The method of depreciation is straight-line.

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

		Individual entity accounting records		Group accounting records	
		CU	CU	CU	CU
SME B					
1 January 20X2					
Dr	Asset—cash	600			
	Cr Asset—property, plant and equipment (PPE)		500		
	Cr Income—profit on sale of PPE		100		
<i>To recognise the sale of the building for cash.</i>					
SME A					
1 January 20X2					
Dr	Asset—PPE	600			
	Cr Asset—cash		600		
<i>To recognise the purchase of a building for cash from SME B.</i>					
31 December 20X2					
Dr	Expense—depreciation	30 ^(b)		25	
	Cr Asset—PPE		30		25
<i>To recognise depreciation for the building in 20X2.</i>					

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

	<i>CU</i>	<i>CU</i>
Dr Income—profit on sale of PPE	100	
Cr Asset—PPE		100
Dr Asset—PPE	5 ^(a)	
Cr Expense—depreciation		5

To eliminate the effects of the intragroup transaction.

The difference between the carrying amount in the consolidated financial statements and the carrying amount in the individual entity financial statements of SME A for the building in 20X2 are summarised:

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

On 1 January 20X2, the group carrying amount of the building is CU100 less than in SME A's individual records. If using the financial information of the individual entities as the starting point from which to prepare the group's consolidated financial statements, these consolidation adjustments eliminate the effects of the intragroup transaction.

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

^(b) The depreciation expense of SME B and the group is CU25 for each year (cost to SME B and to the group (CU525) ÷ years of estimated useful life (21)).

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

Example—Intragroup rent

Ex 38 SME A owns all of the share capital of SME B and, consequently, controls SME B. During 20X2 (the current financial period), SME A rented office space to SME B, for which SME B paid CU100 to SME A. The journal entries for rent processed by SMEs A and B in their individual accounting records for 20X2 are:

	CU	CU
SME A		
Dr Asset—cash	100	
Cr Income—operating lease rent		100

To recognise rental income received in cash.

SME B		
Dr Expense—operating lease rent	100	
Cr Asset—cash		100

To recognise rent paid in cash.

These transactions are internal to the group. Accordingly, the consolidation adjustments required for preparing the group's consolidated financial statements are:

	CU	CU
Dr Income—operating lease rent	100	
Cr Expense—operating lease rent		100

To eliminate the effects of the intragroup transaction.

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

Examples—Intragroup dividends

Ex 39 SME A owns all the share capital of SME B and, consequently, controls SME B. On 31 December 20X2, SME B declared and paid a dividend of CU50 from profits earned after the date on which it was acquired by SME A. The journal entries processed by SMEs A and B in their individual accounting records relating to this transaction are:

	CU	CU
SME A		
Dr Asset—cash	50	
Cr Income—dividends		50

To recognise dividends received in cash.

SME B		
Dr Equity—retained earnings: dividends	50	
Cr Asset—cash		50

To recognise dividends paid in cash.

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

	CU	CU
Dr Income—dividends	50	
Cr Equity—retained earnings		50

To eliminate the effects of the intragroup dividend transaction.

Note: Example 41 illustrates intragroup dividends if the subsidiary is not wholly owned.

Ex 40 The facts are the same as in Example 39. However, in this example, at 31 December 20X2 the dividend is unpaid. The journal entries processed by SMEs A and B in their individual accounting records relating to this transaction are:

	CU	CU
SME A		
Dr Asset—dividend receivable	50	
Cr Income—dividends		50

To recognise the dividend income and the receivable.

SME B

Dr	Dr Equity—retained earnings: dividends	50	
	Cr Liability—dividend payable		50

To recognise the dividends declared and liability to pay dividends.

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

		<i>CU</i>	<i>CU</i>
Dr	Income—dividends	50	
	Cr Asset—dividend receivable		50
Dr	Liability—dividend payable	50	
	Cr Equity—retained earnings: dividends		50

To eliminate the effects of the intragroup dividend transaction.

Ex 41 SME A owns 80% of the share capital of SME B and consequently controls it. In 20X2, SME B declared a dividend of CU1,000 from profits earned after the acquisition date. The journal entries processed by SMEs A and B in their individual accounting records relating to this transaction are:

		<i>CU</i>	<i>CU</i>
SME A			
Dr	Asset—dividend receivable	800	
	Cr Income—dividends		800

To recognise dividend income and the receivable.

SME B

Dr	Equity—retained earnings: dividends	1,000	
	Cr Liability—dividend payable		1,000

To recognise dividends declared and liability to pay dividends.

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

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

To eliminate the intragroup dividend transaction.

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

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

Example—A subsidiary's functional currency differs from the group's reporting currency

Ex 42 On 1 January 20X1, SME A acquired 75% of the share capital, and thus control, of SME B for FCU7,500 (foreign currency unit (FCU) is the functional currency of SME B). On 1 January 20X1, the carrying amount of SME B's net assets was FCU10,000. SME A's functional currency is CU and the presentation currency of the group is CU. The exchange rate on 1 January 20X1 was CU8:FCU1. No goodwill or fair value adjustments arose at acquisition.

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

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

(a) FCU7,500 × 8:1 = CU60,000.

Note: The existence of a subsidiary (SME B) with a different functional currency to the group's presentation currency has little effect upon the necessary consolidation procedures. However, SME B's trial balance is first translated from FCU to CU (see *IFRS for SMEs Accounting Standard—Educational Module 30 Foreign Currency Translation* for additional guidance) before performing the 'normal' consolidation procedures.

Relevant exchange rates are as follows:

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

The entity translates SME B's trial balance from FCU to CU as follows:

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

^(b) This amount is the difference arising on translation of the opening net assets of FCU10,000 from the rate at the start of the year (8:1) to the rate at the end of the year (7:1), plus translating the profit for the year (FCU5,000) at the actual rate for the year (as used in the consolidated statement of comprehensive income) to the closing rate (as used in the consolidated statement of financial position). The calculation would be written as: $[\text{FCU}10,000 \times (8 - 7)] + [\text{FCU}5,000 \times (8 - 7.5)] = \text{CU}12,500$ debit.

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

	SME A	SME B	Consolidation adjustments	Consolidated
	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>
Profit for the year	10,000	37,500		47,500
Other comprehensive income— translation difference	—	—	(12,500) ^(c)	(12,500)
Total comprehensive income for 20X1	10,000	37,500	(12,500)	35,000

Profit for 20X1 is attributed as follows:^(f)

Owners of SME A	38,125
Non-controlling interest	9,375 ^(d)
	47,500

Total comprehensive income for 20X1 is attributed as follows:^(f)

Owners of SME A	28,750
Non-controlling interest	6,250 ^(e)
	35,000

^(c) See the translated trial balance.^(b)

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

^(e) NCI's share (25%) × SME B's profit (CU37,500) – SME B's other comprehensive income (CU12,500) = CU6,250.

^(f) See the discussion on paragraph 9.21.

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

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

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

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

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

^(j) The retained earnings of SME A at 1 January 20X1 (CU80,000) + profit for 20X1 attributable to the owners of SME A taken from the consolidated statement of comprehensive income for 20X1 (CU38,125) = CU118,125.

Uniform reporting date

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

Educational notes

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

Example—Uniform reporting date

- Ex 43 Regulations in the separate jurisdictions in which SME A and its wholly owned subsidiary, SME B, are domiciled specify a financial year end of 31 December for SME A and 30 September for SME B. SME B has been SME A’s wholly owned subsidiary since 20X1.**

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

Uniform accounting policies

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

Educational notes

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

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

Example—Uniform accounting policies

- Ex 44 SME A has a wholly owned subsidiary, SME B. SME A uses the equity method to account for its investments in associates in its separate financial statements. SME B uses the cost model for its associates.**

When preparing the group's consolidated financial statements, SME B's investments in associates are measured using the equity method. This difference between SME B's policy and that of the group will result in adjustments being made on consolidation.

Acquisition and disposal of subsidiaries

- 9.18 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date until the date on which the parent loses control of the subsidiary.
- 9.18A If a parent loses control of a subsidiary, the parent:
- (a) derecognises:
 - (i) the assets (including any **goodwill**) and liabilities at their carrying amounts at the date control is lost in the former subsidiary; and
 - (ii) the carrying amount of any non-controlling interests in the former subsidiary at the date control is lost (including any components of **other comprehensive income** attributable to them);

-
- (b) recognises;
- (i) the **fair value** of the consideration received, if any, from the transaction or event that resulted in the loss of control; and
 - (ii) any interest retained in the former subsidiary at its fair value at the date control is lost; and
- (c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest in profit or loss.

9.18B If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income for that subsidiary, except for the cumulative amount of any exchange differences that relate to a foreign subsidiary, on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. The cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in other comprehensive income in accordance with Section 30 *Foreign Currency Translation* is not reclassified to profit or loss on disposal of the subsidiary.

Educational notes

If a parent loses control of a subsidiary, the former parent no longer consolidates the former subsidiary from the date control is lost. On the date control is lost, the former parent:

- derecognises the carrying amount of assets and liabilities of the former subsidiary and the carrying amount of non-controlling interest, if any;
- recognises the fair value of any consideration received and the fair value of interest retained in the former subsidiary (fair value is determined in accordance with the requirements in Section 12 *Fair Value Measurement* of the Standard); and
- recognises the gain or loss associated with the loss of control in profit or loss.

The cumulative exchange differences that relate to a foreign subsidiary, if any, recognised in other comprehensive income in accordance with Section 30 *Foreign Currency Translation* of the Standard are not reclassified to profit or loss on disposal of the related subsidiary. Other amounts that were recognised in other comprehensive income for the former subsidiary are treated as though the former parent has disposed of the related assets or liabilities. For example, revaluation surplus on an item of property, plant and equipment recognised in other comprehensive income is treated as though the former parent directly disposed of the item of property, plant and equipment.

Example—Loss of control by disposing of a subsidiary in full

Ex 45 SME A has several wholly owned subsidiaries, including SME B. On 30 March 20X1, SME A sold all of the shares in SME B to a third party for CU1,500.

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

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

SME A group's consolidated statement of financial position at 31 March 20X1 after disposal of the subsidiary is as follows:

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

Workings:

When SME A sold SME B, the carrying amount of all assets and liabilities attributable to SME B were derecognised from the consolidated statement of financial position. The fair value of consideration received and the gain on disposal was recognised.

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

^(b) Fair value of consideration received from the sale of SME B (CU1,500) – carrying amount of net assets relating to SME B (CU1,280) = gain on the disposal of SME B (CU220).

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

Note: Assume the consolidated retained earnings of CU2,030 immediately before the disposal of SME B were changed to:

Retained earnings	CU1,850
Foreign currency translation reserve	CU180

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

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

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

- 9.19 If parent loses control of a subsidiary but continues to hold an interest in the former subsidiary, that interest shall be accounted for in accordance with other sections of this Standard. If the retained interest is a **financial asset**, Section 11 *Financial Instruments* applies; if it is an **associate**, Section 14 *Investments in Associates* applies; if it is a **jointly controlled entity**, Section 15 *Joint Arrangements* applies. The fair value at the date control is lost shall be regarded as the fair value on initial recognition of a financial asset or the cost on initial recognition of an investment in an associate or jointly controlled entity, if applicable.

Examples—Loss of control while retaining an interest

Ex 46 SME A had a wholly owned subsidiary, SME B, along with several other wholly owned subsidiaries. On 30 March 20X1, SME A sold 90% of the shares in SME B to a third party for CU1,350. The fair value of the remaining 10% of shares is CU128.

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

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

SME A's consolidated statement of financial position immediately after disposal of the 90% interest in SME B is as follows:

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

Workings:

All assets and liabilities attributable to the subsidiary, SME B, were derecognised from the consolidated statement of financial position and replaced by a financial asset with a fair value of CU128. This amount is the one recognised as cost of the financial asset.

^(a) Financial asset's fair value is CU128.

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

^(c) The gain on the disposal of 90% of the shares (CU198) = the fair value of the consideration received from the sale of 90% of the shares (CU1,350) + fair value of the retained interest (CU128) – carrying amount of net assets relating to SME B (CU1,280).

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

After the parent disposes of the investment in SME B, the parent classifies it as a financial asset from the date SME B ceases to be a subsidiary, in accordance with Section 11 *Financial Instruments* of the Standard.

Ex 47 SME A had a 60% interest in a subsidiary, SME B, and several other wholly owned subsidiaries.

On 30 March 20X1, SME A sold 40% of its interest in SME B to a third party for CU550. SME A recognised no goodwill in the consolidated statement of financial position at the date of the disposal of the shares, because the goodwill was fully amortised. After the disposal, SME A classifies its remaining interest in SME B as an associate in accordance with Section 14 *Investments in Associates* of the Standard. The fair value of the remaining interest on 30 March 20X1 was CU357.

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

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

SME A's consolidated statement of financial position after disposal of 40% of its previous interest in SME B is as follows:

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

Workings:

All assets and liabilities attributable to the subsidiary, SME B, were derecognised from the consolidated statement of financial position.

The NCI was also derecognised from the consolidated statement of financial position because SME A no longer controls SME B.

A new asset was recognised in the consolidated statement of financial position of SME A: Investment in associate.

^(a) Investment in the associate of CU357 (the remaining interest's fair value).

^(b) Cash before disposal of 40% interest (CU1,550) – cash of SME B (CU500) + proceeds from the sale of 40% of the shares (CU550) = cash (CU1,600).

^(c) The gain on the disposal of 40% of the shares (CU193) = the fair value of the consideration received from the sale of 40% interest (CU550) + fair value of the retained interest (CU357) – carrying amount of net assets relating to SME B (CU1,190) + non-controlling interest (CU476).

Retained earnings before disposal of the 40% of the shares (CU1,464) + gain on the disposal of the 40% of the shares (CU193) = retained earnings (CU1,657).

From the date SME B ceases to be SME A's subsidiary, SME A classifies its investment in SME B as an associate in accordance with Section 14.

Non-controlling interest in subsidiaries

- 9.20 An entity shall present non-controlling interest in the consolidated **statement of financial position** within equity, separately from the equity of the owners of the parent, as required by paragraph 4.2(q).
- 9.20A An entity shall treat changes in a parent's controlling interest in a subsidiary that do not result in a loss of control as transactions with owners in their capacity as owners. Accordingly, the carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to owners of the parent. An entity shall not recognise any gain or loss on these changes. Also, an entity shall not recognise any change in the carrying amount of assets (including goodwill) or liabilities as a result of such transactions.

Educational notes

If a parent does not wholly own a subsidiary, the portion of the equity not owned directly by the parent or indirectly through any of its subsidiaries is the non-controlling interest (NCI). The NCI is equity of the group because the NCI does not satisfy the definition of a liability in Section 2 *Concepts and Pervasive Principles* of the Standard. Paragraph 4.2(q) of Section 4 *Statement of Financial Position* of the Standard requires an entity to present NCI in the statement of financial position within equity but separate from the equity attributable to the owners of the parent, like so:

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

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

If a parent changes its ownership share without losing control, it treats the change as a transaction between owners. The parent updates the NCI to reflect the parent's new interest holdings and recognises any difference between the consideration paid or received and the change in NCI directly in equity. The carrying amounts of assets, liabilities and goodwill do not change as a result of such transactions.

Example—Non-controlling interest

Ex 48 SME A owns 80% of SME B. The carrying amount of SME B's net assets is CU80,000. On 31 December 20X1, SME A buys an additional 10% in SME B from NCI for CU12,000.

This transaction is treated as a transaction between owners because SME A retains control of SME B. The carrying amount of NCI is adjusted from 20% to 10%. The difference between the consideration paid and the adjustment of the NCI is recognised directly in equity.

The following journal entry is processed:

	CU	CU
Dr Equity—NCI	8,000 ^(a)	
Dr Equity	4,000 ^(b)	
Cr Asset—cash		12,000

^(a) NCI before the change (20% × CU80,000) = CU16,000. The new NCI after the change (10% × CU80,000) = CU8,000.

^(b) Consideration paid (CU12,000) – the adjustment to NCI (CU8,000) = CU 4,000.

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

Educational notes

Paragraph 5.6 of Section 5 *Statement of Comprehensive Income and Income Statement* of the Standard requires an entity to make separate disclosure in the statement of comprehensive income, as allocations for the period, for:

- profit or loss for the period attributable to:
 - non-controlling interest; and
 - owners of the parent; and
- total comprehensive income for the period attributable to:
 - non-controlling interest; and
 - owners of the parent.

The presentation is illustrated in Example 49.

Example—Disclosing non-controlling interest

Ex 49 SME A has an 80% interest in its subsidiary, SME B. SME A could disclose the total comprehensive income and profit or loss attributable to the 20% NCI in the consolidated statement of comprehensive income as follows:

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

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

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

Educational notes

The disclosure described in paragraph 9.22 is, usually, presented in the statement of changes in equity. Example 50 illustrates one possible form of such disclosure.

Example—Attributing profit or loss and comprehensive income

Ex 50 SME A has an 80% investment in a subsidiary. As illustrated in Example 49, profit or loss, and each component of other comprehensive income can be attributed to the owners of the parent (that is, the shareholders of SME A) and to the non-controlling interest in the consolidated statement of changes in equity as follows:

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

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

Notes:

- Comparative information is also required to be presented.
- Amounts are only included in the NCI column to the extent that the item affects the subsidiary in which the NCI has an interest.
- Each item of other comprehensive income need not be presented separately in the statement of changes in equity. An entity is permitted to combine and present them as one item, presented in a single row.

Disclosures in consolidated financial statements

- 9.23 The following disclosures shall be made in consolidated financial statements:
- (a) the fact that the financial statements are consolidated financial statements;
 - (b) [deleted]
 - (c) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements; and
 - (d) the nature and extent of any significant restrictions (for example resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans.

Example—Disclosures in consolidated financial statements

Ex 51 SME A has three subsidiaries (SMEs B, C and D) and prepares its consolidated financial statements in accordance with the Standard.

SME A could disclose the information required by paragraph 9.23 as follows:

Note 10 Subsidiaries

These consolidated financial statements include the financial statements of SME A and its three subsidiaries (SMEs B, C and D). SME D is a wholly owned subsidiary that operates in Jurisdiction X and does not have the same functional currency as the other group entities.

SMEs A, B and C have 31 December year-ends. SME D, in accordance with the legislation in Jurisdiction X, has a 31 October year-end. Consequently, SME D prepares financial information for the year to 31 December for the purpose of preparing the consolidated financial statements.

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

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

Example—Disclosure of carrying amount of investments in unconsolidated subsidiaries

Ex 52 The information required by paragraph 9.23A could be disclosed as follows:

Note 8 Equity instruments (extract)

Included in the amount of CU15,000 (20X4—CU7,400) for equity instruments carried at fair value through profit or loss is CU6,500 (20X4—nil) that is attributable to SME H. SME H was acquired as part of the acquisition of Group D in September 20X5. After the acquisition, a buyer was sought for SME H. Since the end of the reporting period, the sale of SME H for CU6,500 has been completed.

9.23B An entity shall disclose the gain or loss, if any, calculated in accordance with paragraph 9.18–9.18B, and:

- (a) the portion of that gain or loss attributable to measuring any interest retained in the former subsidiary at its fair value at the date control is lost; and
- (b) the line items in profit or loss in which the gain or loss is recognised (if not presented separately).

Example—Disclosure of gain or loss

Ex 53 On 1 July 20X5, SME A disposed of 70% of its interest in SME B, resulting in it losing of control of SME B. SME A retained a 30% interest, which it classified as an associate, and used the equity method in accordance with the Standard.

SME A could disclose the information required by paragraph 9.23B as follows:

Note 9 Disposal of SME B (extract)

On 1 July 20X5, the Group disposed of 70% of its subsidiary SME B, reducing its ownership from 100% to 30% and losing control of SME B. The assets and liabilities of SME B were derecognised from the consolidated financial statements.

A total gain of CU150,000 was recognised in profit or loss from the disposal. CU90,000 of the gain is attributable to measuring the retained 30% interest at its fair value at the date control was lost.

The gain is presented in the consolidated statement of profit or loss in 'Other income'.

Separate financial statements

Presentation of separate financial statements

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

Educational notes

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

A parent assesses its eligibility to use the Standard in its separate financial statements on the basis of its own public accountability without considering whether other group entities have, or the group as a whole has, public accountability (see paragraph 1.3 of Section 1).

- 9.25 Separate financial statements are presented by an entity in addition to any of the following:
- (a) consolidated financial statements prepared by a parent;
 - (b) financial statements prepared by a parent exempted from preparing consolidated financial statements by paragraph 9.3C; or
 - (c) financial statements prepared by an entity that is not a parent but has significant influence over an associate or has joint control of a jointly controlled entity.
- 9.25A A parent that is exempt in accordance with paragraph 9.3 from preparing consolidated financial statements is permitted to present separate financial statements as its only financial statements.

Educational notes

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

An entity is permitted to present separate financial statements if it chooses, or is required by local regulation (for tax purposes), to do so. The Standard sets out how an entity is required to prepare separate financial statements and some disclosures the entity is required to include in them, but the Standard does not in itself require the entity to present separate financial statements.

If an entity presents separate financial statements, it presents them in addition to consolidated financial statements or other main financial statements.

If a parent is exempt from producing consolidated financial statements in accordance with paragraph 9.3, it is allowed to present separate financial statements as its only financial statements. If such a parent has an interest in an associate or joint arrangement, it accounts for its investments in subsidiaries, associates and jointly controlled entities in its financial statements in accordance with the requirements in Section 11 instead of those in Section 9.

Accounting policy election

- 9.26 When an entity prepares separate financial statements and describes them as conforming to the *IFRS for SMEs* Accounting Standard, those statements shall comply with all of the requirements of this Standard except as follows. The entity shall adopt a policy of accounting for its investments in subsidiaries, associates and jointly controlled entities in its separate financial statements either:
- (a) at cost less impairment;
 - (b) at fair value with changes in fair value recognised in profit or loss; or
 - (c) using the equity method following the procedures in paragraph 14.8.

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

Educational notes

An entity is required to adopt the same accounting policy for all investments within the same class: subsidiaries, associates or jointly controlled entities. For example, if an entity adopts the cost less impairment accounting policy for a subsidiary, it applies the policy to all subsidiaries.

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

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

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

Examples—Accounting policy choice

Ex 54 SME A has two subsidiaries. SME A prepares its separate financial statements applying the Standard. SME A plans to adopt two accounting policies for its investments in subsidiaries in its separate financial statements:

- cost less impairment for the subsidiary in Jurisdiction X; and
- fair value with changes in fair value recognised in profit or loss for the subsidiary in Jurisdiction Y.

SME A has two subsidiaries (two investments of the same class). It does not matter that they are based in different regions or that they can be distinguished in some other way. SME A is required to apply the same accounting policy for all its investments in subsidiaries.

Ex 55 SME A has one subsidiary and one associate. SME A prepares separate financial statements applying the Standard. SME A plans to account in those financial statements for:

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

SME A can choose different accounting policies for different classes of investments in its separate financial statements. Consequently, the accounting policy choices that SME A plans to adopt are appropriate.

In this example, SME A recognises the investment in the subsidiary at cost less impairment and the investment in the associate using the equity method.

Disclosures in separate financial statements

- 9.27 When an entity prepares separate financial statements, those separate financial statements shall disclose:
- (a) that the statements are separate financial statements;
 - (b) a description of the methods used to account for the investments in subsidiaries, jointly controlled entities and associates; and
 - (c) either:
 - (i) the consolidated financial statements or other financial statements to which they relate; or
 - (ii) the name and principal place of business (and country of incorporation, if different) of the entity whose consolidated financial statements comply with full IFRS Accounting Standards or with this Standard, if the entity has chosen not to prepare consolidated financial statements in accordance with paragraph 9.3.

Example—Disclosures in separate financial statements

Ex 56 SME A has a wholly owned subsidiary, SME B. The group prepares consolidated financial statements applying Section 9. In addition, SME A is required to present separate financial statements.

SME A prepares its separate financial statements in accordance with the Standard and includes the following note:

...

Note X Significant accounting policies

Investment in subsidiary (SME B)

The investment in SME B is measured at fair value with changes in the fair value of the investment recognised in profit or loss.

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

Combined financial statements

9.28 Combined financial statements are the financial statements of a **reporting entity** that comprises two or more entities that are not all linked by a parent–subsidiary relationship. This Standard does not require combined financial statements to be prepared.

Educational notes

Combined financial statements present the financial position, performance and cash flows of a reporting entity that includes two or more entities that are not linked by a parent–subsidiary relationship. The entities might be under common control or ownership, or have some form of operations-related or managerial link that justifies presenting their financial information together.

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

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

Educational notes

If preparing combined financial statements, an entity is required to meet all requirements of the Standard. Combined financial statements constitute a complete set of financial statements in accordance with paragraphs 3.17–3.22 of Section 3 *Financial Statement Presentation* of the Standard. Combined financial statements present the assets, liabilities, equity, income and expenses of a reporting entity that comprises two or more entities that are not linked by a parent–subsidiary relationship.

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

Example—Combined financial statements

Ex 57 Mr X owns all of the share capital of both SMEs A and B, which are domiciled in Jurisdiction Y. The presentation of combined financial statements is required by law in Jurisdiction Y. Both SMEs A and B were established on 31 December 20X0. In the 20X1 financial year, no transactions occurred between SMEs A and B.

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

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

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

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

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

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

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

Combined statement of financial position at 31 December 20X1

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

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

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

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

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

Notes:

- Property, plant and equipment in SME B (CU600) were purchased on short-term credit. This amount was outstanding at 31 December 20X1.
- The columns for SMEs A and B in this example would not be presented in the combined financial statements.
- The entities were set up on the last day of 20X0 and so there is no comparative information to be presented. However, typically, combined financial statements would show comparative information in accordance with paragraphs 3.14 and 3.20 of Section 3.

Ex 58 The facts are the same as those in Example 57, except:

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

Assume that SME B's revenue was CU100 lower than in Example 57 (it is now CU3,050 instead of CU3,150) so that, after reflecting the rent received from SME A, SME B's profit for the year is the same as in Example 57.

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

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

	CU	CU
SME A		
Dr Asset—cash	1,000	
Cr Income—revenue		1,000
Dr Expense—cost of sales	800	
Cr Asset—inventory		800

To recognise the sale of inventory to SME B for cash.

SME B		
Dr Asset—inventory	1,000	
Cr Asset—cash		1,000

To recognise the purchase of inventory from SME A for cash.

Dr Asset—cash	1,500	
Cr Income—revenue		1,500
Dr Expense—cost of sales	1,000	
Cr Asset—inventory		1,000

To recognise the sale of inventory for cash.

	CU	CU
SME A		
Dr Expense—rent	100	
Cr Asset—cash		100

To recognise the rent paid in cash to SME B.

SME B		
Dr Asset—cash	100	
Cr Income—rent		100

To recognise income from rent received from SME A in cash.

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

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

To eliminate the effects of the transaction in which SME A sold inventory to SME B.

SME A recognises a profit of CU200 (revenue from the sale of goods (CU1,000) – cost of sales (CU800)). SME B recognises a profit of CU500 (revenue from the sale of goods (CU1,500) – cost of sales (CU1,000)). Total profit is CU700.

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

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

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

To eliminate the effects of the transaction in which SME A rented office space from SME B.

The combined financial statements are as follows:

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

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

The other income of SME B relates to the rent income.

Combined statement of financial position at 31 December 20X1

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

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

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

Notes:

- Property, plant and equipment in SME B (CU600) was purchased on short-term credit. This amount was outstanding at 31 December 20X1.
- The columns for SMEs A and B in this example would not be presented in the combined financial statements.

Disclosures in combined financial statements

- 9.30 The combined financial statements shall disclose the following:
- the fact that the financial statements are combined financial statements;
 - the reason why combined financial statements are prepared;
 - the basis for determining which entities are included in the combined financial statements;
 - the basis of preparation of the combined financial statements; and
 - the **related party** disclosures required by Section 33 *Related Party Disclosures*.

Example—Disclosures in combined financial statements

Ex 59 The facts are the same as in Example 58. However, in this example, SME B purchased inventory from and rented office space to Mr X, the sole owner of SMEs A and B (instead of renting from and to SME A). The disclosures required to be included in the combined financial statements could be presented as follows:

Notes to the combined financial statements

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

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

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

...

Related party disclosure (extract)

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

In 20X1 the following transactions occurred between Mr X and SME A and SME B:

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

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

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs Accounting Standard* (Standard) to transactions and events often requires an entity to use its judgement. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful to a user of financial statements assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6 of Section 8 *Notes to the Financial Statements* of the Standard, an entity discloses the judgements management has made when applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, in accordance with paragraph 8.7 of Section 8, an entity discloses information about the key assumptions about the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Control

Determining whether an entity has control over an investee applying the definition of control in paragraph 9.4A of Section 9 *Consolidated and Separate Financial Statements* of the Standard (that is, the elements of control listed in paragraph 9.4B of Section 9) might in specific circumstances require judgement, including assessing whether an investor:

- has power over an investee;
- has the current ability to exercise its rights, including potential voting rights that might require the entity to use judgement; and
- is exposed to variable returns from its involvement with the investee, which involves assessing the nature of the returns and the investor's ability to use its power to affect the returns.

Control is presumed to exist if the investor directly owns, or indirectly owns through subsidiaries, a majority of the voting rights of an investee. In some circumstances, ownership of the majority of the voting rights might not constitute control and the presumption can be rebutted if it can be clearly demonstrated that the investor does not have one of the elements of control listed in paragraph 9.4B. Judgement is required in demonstrating that the investor does not have one or more of the elements of control.

Paragraph 9.7B clarifies the circumstances in which an investor can have power over an investee even if the investor owns less than a majority of the voting rights of the investee. If control is not established through a majority of voting rights, judgement might need to be applied to determine whether other factors result in control.

Consolidation procedures

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

Further, materiality considerations are made if the parent and subsidiaries have different financial year-ends. In such situations, it is necessary to determine whether and what adjustments are made when preparing consolidated financial statements.

Measurement

If a parent chooses to prepare separate financial statements in accordance with paragraph 9.25 of Section 9, after initial recognition an entity measures all its investments using the cost model, the equity method or the fair value model.

Cost model

If an entity chooses to use the cost model or the equity method, significant judgements relating to accounting for any impairment of investments include:

- assessing whether there is any indication that an investment might be impaired (see paragraph 27.7 of Section 27 *Impairment of Assets* of the Standard); and
- if there is an indication that the investment might be impaired, estimating the recoverable amount of that investment (see paragraph 27.11 of Section 27).

Equity method

If an entity chooses to use the equity method, see *IFRS for SMEs Accounting Standard—Educational Module 14 Investments in Associates* for a discussion of using judgement in applying the requirements of Section 14 *Investments in Associates* of the Standard.

Fair value model

If an entity adopts the fair value model for measurement after initial recognition, significant judgements might be necessary in deciding which valuation model to use and determining the inputs for that model in cases in which the shares in an investment are not quoted in an active market. For application guidance on fair value measurement, see *IFRS for SMEs Accounting Standard—Educational Module 12 Fair Value Measurement*.

Other sections of the *IFRS for SMEs Accounting Standard*

For judgements and estimates in accounting for business combinations, see *IFRS for SMEs Accounting Standard—Educational Module 19 Business Combinations and Goodwill*.

TRANSITION REQUIREMENTS

The third edition of the *IFRS for SMEs Accounting Standard* (Standard) is effective for annual reporting periods beginning on or after 1 January 2027. Early application is permitted. Changes made to Section 9 *Consolidated and Separate Financial Statements* from the second edition of the Standard are summarised on page 7.

Control model

- A5 If an entity applies the amended requirements in Section 9 *Consolidated and Separate Financial Statements* at the date of initial application and as a result consolidates an investee not previously consolidated, the entity shall:
- (a) measure the **assets, liabilities** and **non-controlling interests** (including **goodwill**, if the investee is a **business**) as if the investee had been consolidated from the date the entity obtained **control**. The investor shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date the investor obtained control is earlier than the beginning of that period, the investor shall recognise, as an adjustment to equity at the beginning of that period, any difference between:
 - (i) the amount of assets, liabilities and non-controlling interests recognised; and
 - (ii) the previous **carrying amount** of the investor's involvement with the investee.
 - (b) if (a) is **impracticable**, make the adjustments required by paragraph (a) from the earliest period practicable, which might be the current period.
- A6 If an entity applies the amended requirements in Section 9 at the date of initial application and as a result no longer consolidates an investee it previously consolidated, the entity shall:
- (a) measure its interest in the investee as the amount the entity would have measured if the requirements in Section 9 had been effective when the entity initially recognised the investee. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. The entity shall also recognise as an adjustment to equity at the beginning of that period any difference between:
 - (i) the previous carrying amount of the assets, liabilities and non-controlling interests; and
 - (ii) the recognised amount of the interest in the investee.
 - (b) if measuring the interest in the investee in accordance with (a) is impracticable, make the adjustments required by paragraph (a) from the earliest period practicable, which might be the current period.

-
- A7 If an entity applies paragraph A6(a) and applies the cost model in accordance with paragraph 14.4 or 15.9 and it is impracticable to determine the cost at the date of purchase, the entity is permitted to measure the cost (deemed cost) as either:
- (a) **fair value** at the date of initial application; or
 - (b) the aggregate of the carrying amounts at the date of initial application of the assets and liabilities, including goodwill, that the entity had previously consolidated.
- A8 At the date of initial application an entity is not required to make adjustments for previous accounting periods for its involvement in entities that:
- (a) would have been consolidated before the date of initial application and are still consolidated applying the amended requirements in Section 9; and
 - (b) would not have been consolidated before the date of initial application and are not consolidated applying the amended requirements in Section 9.
- A9 An entity applying the amended requirements in Section 9 is only required to disclose the amount of the adjustment for each line item affected in accordance with paragraph 10.13(b) for the annual period immediately preceding the date of initial application (and not earlier comparative periods), and only if it has restated comparative information in accordance with this appendix.
- A10 An entity shall not restate the carrying amount of an investment in a former **subsidiary** if the entity lost control before the date of initial application. In addition, an entity shall not remeasure any gain or loss on the loss of control of a former subsidiary that occurred before the date of initial application. An entity is not required to apply the disclosure requirements in paragraph 9.23B to comparative information provided for periods before the date of initial application.

Educational notes

An entity is required to retrospectively apply the recognition and measurement requirements in Section 9, in accordance with Section 10 *Accounting Policies, Estimates and Errors* of the Standard. However, Section 10 provides several reliefs for an entity retrospectively applying the requirements in Section 9.

Consolidating an investee not previously consolidated (paragraph A5)

If an entity applies the third edition of the Standard for the first time and consolidates an investee it had not consolidated previously, the investee is consolidated as if it had been consolidated from the date control was obtained. That is, the entity retrospectively adjusts amounts previously reported. The entity adjusts prior periods to reflect control being obtained in a reporting period before the period of initial application of the third edition of the Standard. The entity makes the adjustment to the opening balance of equity. If it is impracticable to make such adjustments (the entity cannot make the adjustment after making every reasonable effort), the entity makes the adjustments from the earliest period practicable.

No longer consolidating an investee that was previously consolidated (paragraphs A6–A7)

If an entity applies the third edition of the Standard for the first time and it no longer consolidates an investee it had previously consolidated, the entity applies the requirements in Section 9. That is, it retrospectively adjusts prior periods. The entity adjusts prior periods to reflect that it did not control the investee and adjusts the equity for the difference between what was previously recognised relating to the subsidiary (assets, liabilities and non-controlling interest) and the recognised amount of the investee. If it is impracticable to make such adjustments (the entity cannot make the adjustment after making every reasonable effort), the entity instead makes adjustments from the earliest period practicable. If it is impracticable to determine the cost when using the cost model, the entity is permitted to use a 'deemed cost'.

No adjustments required (paragraph A8)

An entity need not make adjustments if applying Section 9 does not change whether the investee is consolidated or not consolidated—that is, if an investee was previously consolidated and continues to be consolidated, or if an investee was previously not consolidated and continues not to be consolidated.

Disclosure (paragraph A9)

Relief is granted for disclosures on transition. An entity is required to disclose adjustments that were made on transition for the period before date of initial application and not for earlier periods.

Losing control before date of initial application (paragraph A10)

If an entity lost control of a subsidiary before date of initial application, no adjustments are required.

COMPARISON WITH FULL IFRS ACCOUNTING STANDARDS

The requirements in full IFRS Accounting Standards (specifically, IFRS 3 *Business Combinations*, IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* and IFRS 12 *Disclosure of Interests in Other Entities*) and the *IFRS for SMEs* Accounting Standard (see Section 9 *Consolidated and Separate Financial Statements*) include some differences as at February 2025. The main differences are:

Requirement to prepare consolidated financial statements

A parent applying the *IFRS for SMEs* Accounting Standard need not present consolidated financial statements if the parent is itself a subsidiary and its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with full IFRS Accounting Standards or the *IFRS for SMEs* Accounting Standard.

A parent applying IFRS 10 need not present consolidated financial statements if:

- it is a wholly owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
- its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
- it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
- its ultimate or any intermediate parent produces financial statements that are available for public use and comply with full IFRS Accounting Standards, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with IFRS 10.

Control—What to consolidate

Both full IFRS Accounting Standards and the *IFRS for SMEs* Accounting Standard use the same definition of ‘control’ (control model) as the single basis to determine what is consolidated. Section 9 includes a rebuttable presumption as a simplification of the control model (see the explanation of the rebuttable presumption in the ‘Requirements and Explanations’ section of this module).

Investment entities

IFRS 10 requires subsidiaries of investment entities to be measured at fair value with changes recognised in profit or loss. The *IFRS for SMEs* Accounting Standard requires consolidation and does not include requirements for investment entities.

Non-controlling interest

In accordance with the *IFRS for SMEs* Accounting Standard, an entity measures non-controlling interest 'at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets.' This method is sometimes called 'the proportionate share method'.

Applying paragraph 19 of IFRS 3, non-controlling interest is measured using either the fair value method (sometimes referred to as 'the full goodwill method') or the proportionate share method.

Disposal of foreign operation that was a subsidiary

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

Separate financial statements

If separate financial statements of a parent are prepared in accordance with the *IFRS for SMEs* Accounting Standard, an entity is required to choose one policy of accounting for a class of investment (subsidiaries, associates and jointly controlled entities): at cost less impairment, at fair value with changes in fair value being recognised in profit or loss, or by applying the equity method. In accordance with full IFRS Accounting Standards, an entity that prepares separate financial statements accounts for its investment in subsidiaries, joint ventures and associates in accordance with IFRS 9 *Financial Instruments*, at cost or using the equity method.

Combined financial statements

The *IFRS for SMEs* Accounting Standard defines combined financial statements as the financial statements of a reporting entity that comprises two or more entities that are not all linked by a parent–subsidiary relationship. Full IFRS Accounting Standards do not address combined financial statements.

Uniform reporting period

The *IFRS for SMEs* Accounting Standard requires an entity to prepare consolidated financial statements using the financial statements of a parent and its subsidiaries prepared as of the same reporting date 'unless it is impracticable to do so'. If it is impracticable, the parent is required to consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary, adjusted for the effects of significant transactions or events that occurred between the date of those financial statements and the date of the consolidated financial statements. IFRS 10 has similar requirements and specifies that:

- three months is the maximum permitted difference between the reporting dates; and
- any difference between the dates of the financial statements stay the same from period to period.

Subsidiaries acquired and held for sale

The *IFRS for SMEs* Accounting Standard states that a subsidiary is not consolidated if it is acquired and held with the intention of selling or disposing of it within one year from its acquisition date. In accordance with full IFRS Accounting Standards, subsidiaries that meet specific criteria are measured and presented in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

This table sets out the disclosure requirements related to subsidiaries in IAS 27 compared to those in Section 9.

IAS 27 paragraph	Section 9 paragraph
16(a) and (c)	9.27(a)–(c)
16(b)	X
17(a) and (c)	9.27(c)(i)
17(b)	X
16A	X

X denotes no equivalent paragraph.

This table sets out the disclosure requirements related to subsidiaries in IFRS 12 compared to those in Section 9.

IFRS 12 paragraph	Section 9 paragraph
1–4	X
5(b), 5A and 6(b)	X
B4	X
7–9	X
X	9.23A
9A–9B	X
10	X
11(a)	9.23(c)
11(b)	X
12	X
13(a)	9.23(d)
13(b)–(c)	X
14–18	X
19	9.23B
19A–19C	X

IFRS 12 paragraph	Section 9 paragraph
19D(a)	9.23(d)
19D(b)	X
19E–19G	X
20	X
21(a)	X
21(b)(i)	X
21A	X
22	X
23(a)–(b)	X
24–25	X
25A	X
26–31	X
B10–B11	X
B12(a)	14.13
B12(b)(i)–(v)	X
B12(b)(vi)–(vii)	14.14, 15.20
B13–B15	X
X	15.19(b)
B16(a)–(d)	X
B17	X
B18	15.19(d)
B19	X
B25	X
X	9.30
X	15.21
B26	X

X denotes no equivalent paragraph.

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements in Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Accounting Standard by answering the questions provided.

Assume all amounts mentioned are material.

Once you have completed the test, check your answers against those supplied on page 110.

Mark the box next to the most correct statement.

Question 1

A subsidiary is:

- ☐ (a) an entity over which an investor has significant influence.
- ☐ (b) an entity that is controlled by another entity.
- ☐ (c) an entity over which an investor has joint control.
- ☐ (d) an entity that has one or more associates.

Question 2

SME A owns 30% of the voting interest in SME Z. It also owns convertible debt issued by SME Z such that, if SME A chose to convert it now, it would have 60% of the voting interest in SME Z. The rights are currently exercisable.

Does SME A have power over SME Z?

- ☐ (a) Yes.
- ☐ (b) No.

Question 3

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

- ☐ (a) At cost less accumulated impairment.
- ☐ (b) At fair value with changes in fair value recognised in profit or loss.
- ☐ (c) Using the equity method.
- ☐ (d) SME A can choose to apply either of the accounting policies described in (a) and (b).
- ☐ (e) SME A can choose to apply the accounting policies described in either (a) or (c).
- ☐ (f) SME A can choose to apply the accounting policies described in either (a), (b) or (c).

Question 4

SME A, a manufacturing company, acquired control of a rugby club. SME A's management decided to exclude the rugby club from consolidation on the grounds that its activities are dissimilar from those of SME A's manufacturing operations. How does SME A account for its investment in the rugby club in its consolidated financial statements?

- ☐ (a) Because the rugby club's activities are dissimilar from those of SME A (manufacturing), SME A accounts for the rugby club using the equity method.
- ☐ (b) Because the rugby club's activities are dissimilar from those of SME A (manufacturing), SME A accounts for the rugby club at cost less accumulated impairment.
- ☐ (c) The rugby club is required to be consolidated. A subsidiary is not excluded from consolidation simply because it has activities that are dissimilar to those of the investor.

Question 5

Which of the following is **not** a valid condition for exemption from presenting consolidated financial statements?

- ☐ (a) The parent is itself a subsidiary and its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with full IFRS Accounting Standards or with the *IFRS for SMEs* Accounting Standard.
- ☐ (b) The parent has no subsidiaries other than one that it acquired with the intention of selling or disposing of it within one year.
- ☐ (c) The parent is itself a subsidiary and its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with the local GAAP applicable in the jurisdiction in which that parent operates, which is not full IFRS Accounting Standards or the *IFRS for SMEs* Accounting Standard.

Question 6

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

- ☐ (a) consolidates SME C.
- ☐ (b) accounts for its investment in SME C at its fair value with changes in fair value recognised in profit or loss.
- ☐ (c) accounts for its investment in SME C at its fair value with changes in fair value recognised in other comprehensive income.
- ☐ (d) accounts for its investment in SME C at cost less impairment.
- ☐ (e) chooses any of the above. If SME B decides not to consolidate SME C, it discloses the reasons for this decision.

Question 7

An investor controls an investee if the investor has:

- ☐ (a) power over the investee.
- ☐ (b) exposure, or rights, to variable returns arising from its involvement with the investee.
- ☐ (c) the ability to use its power over the investee to affect the investor's returns.
- ☐ (d) (a) and (b).
- ☐ (e) (a), (b) and (c).

Question 8

SME A owns 70% of the voting rights of SME B. SME C owns 10% of the voting rights of SME B. SME C has a contractual arrangement with all the investors in SME B to direct the relevant activities of SME B. Can SME A rebut the presumption in paragraph 9.5 of Section 9?

- ☐ (a) No.
- ☐ (b) Yes.

Question 9

Which of the following best describes 'relevant activities' for the purpose of determining control?

- ☐ (a) Activities carried out by the investee's employees on a daily basis, such as administrative tasks.
- ☐ (b) Activities that significantly affect the investee's returns.
- ☐ (c) Activities carried out to comply with tax laws and regulations.

Question 10

SME A has determined that it controls SME B. SME B owns 70% of the voting interest in SME C. SME B determines that it controls SME C. How does SME A account for its investment in SME C in its consolidated financial statements?

- ☐ (a) SME A consolidates SME C.
- ☐ (b) SME A accounts for its investment in SME C using the equity method.
- ☐ (c) SME A accounts for its investment in SME C using the policy it has adopted to account for associates.

Question 11

The facts are the same as those in Question 10, additionally SME A owns 60% of the voting interest in SME B. Determine the percentage of the increases in SME C's equity since acquisition that should be attributed to SME A in the consolidated financial statements.

- ☐ (a) 70%.
- ☐ (b) 60%.
- ☐ (c) 42%.

Question 12

SME A owns 60% of the voting interest in SME B and 10% of the voting interest in SME C. SME A has determined that it controls SME B. SME B owns 30% of the voting interest in SME C. SME B has determined that it does not control SME C. How does SME A account for its investment in SME C in its consolidated financial statements?

- ☐ (a) As a subsidiary, because SME A controls SME C.
- ☐ (b) As an associate.
- ☐ (c) As an associate, if SME A can ascertain that it has significant influence over SME C.

Question 13

SME A owns 60% of the voting interest in SME B and 10% of the voting interest in SME C. SME A has determined that it controls SME B. SME B owns 50% of the voting interest in SME C. SME B has determined that it controls SME C. How does SME A account for its investment in SME C in its consolidated financial statements?

- ☐ (a) As a subsidiary, because SME A controls SME C.
- ☐ (b) As an associate.
- ☐ (c) As an associate, if SME A can ascertain that it has significant influence over SME C.

Question 14

SME A holds 100% of the ordinary shares in SME C, which carry voting rights at a general meeting of shareholders. SME A has determined it has control over SME C. SME C sold inventory to SME A (at a markup of 25% on cost) for CU125. SME A is still holding the inventory at the end of its accounting period. What is the carrying amount of the inventory in the consolidated financial statements?

- ☐ (a) CU125.
- ☐ (b) CU100.
- ☐ (c) CU75.
- ☐ (d) CU150.

Question 15

In the separate financial statements of a parent (if presented), investments in subsidiaries are measured:

- ☐ (a) at cost less impairment.
- ☐ (b) using the equity method.
- ☐ (c) at fair value with changes in fair value recognised in other comprehensive income.
- ☐ (d) at fair value with changes in fair value recognised in profit or loss.
- ☐ (e) at cost less impairment, or using the equity method, or at fair value with changes in fair value recognised in other comprehensive income.
- ☐ (f) at cost less impairment, or using the equity method, or at fair value with changes in fair value recognised in profit or loss.

Question 16

Presentation of separate financial statements is:

- ☐ (a) required for a parent applying the *IFRS for SMEs* Accounting Standard.
- ☐ (b) required for an individual subsidiary applying the *IFRS for SMEs* Accounting Standard.
- ☐ (c) not required for a parent or an individual subsidiary applying the *IFRS for SMEs* Accounting Standard.

Question 17

If a parent loses control of a former subsidiary but retains an interest in it, which of the following statements is incorrect?

- ☐ (a) The parent derecognises the assets and liabilities of the former subsidiary at their carrying amount.
- ☐ (b) The parent recognises any retained interest in the former subsidiary at cost.
- ☐ (c) The parent recognises the fair value of any consideration received from the transaction.
- ☐ (d) The parent derecognises the carrying amount of any non-controlling interests in the former subsidiary at the date control is lost.

Answers

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

Q2 (a)—see paragraphs 9.5 and 9.8.

SME Z is a subsidiary of SME A.

Q3 (f)—see paragraph 9.26.

Q4 (c)—see paragraph 9.3D(b).

A subsidiary is not excluded from consolidation because its activities are dissimilar from those of other entities within the group.

Q5 (c)—see paragraph 9.3.

The exemption applies only if the parent or ultimate parent prepares consolidated general purpose financial statements in accordance with full IFRS Accounting Standards or the *IFRS for SMEs* Accounting Standard. It does not apply if they are prepared in accordance with a local GAAP.

Q6 (a)—see paragraph 9.3D(a).

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

Q7 (e)—see paragraph 9.4B.

An investor is required to have all three elements of control to control an investee.

Q8 (b)—see paragraph 9.5.

SME A can rebut the presumption in paragraph 9.5 because it can be clearly demonstrated that SME A does not have power over SME B even though SME A holds 70% of the voting interest. SME C has a contractual arrangement that gives it the current ability to direct the relevant activities of SME B.

Q9 (b)—see paragraph 9.6 and the Glossary.

Relevant activities are those that significantly affect the investee's returns.

Q10 (a)—see paragraph 9.5.

SME A can, through its control of SME B, control SME C.

Q11 (c)—see paragraph 9.5.

SME A can control how SME B, for example, votes on its 70% shareholding in SME C. However, SME A's proportion of SME C's post-acquisition profits is less than 70% because SME A does not wholly own SME B. If SME C made a distribution of CU100, only CU70 of it would be received by SME B. If SME B distributed the CU70 to its owners, SME A would receive 60% of it, CU42.

Q12 (c)—see paragraph 9.5.

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

Q13 (a)—see paragraph 9.5.

SME A controls 60% of the voting interest in SME C: it directly controls 10% and, through its control of SME B, it indirectly controls another 50%.

Q14 (b)—see paragraph 9.15.

Profit resulting from intragroup transactions that is recognised in the carrying amount of inventory is eliminated in full. The cost to SME C of the inventory was CU100 ($\text{CU125} \div 125\%$, 25% being the markup on cost).

Q15 (f)—see paragraph 9.26.

Q16 (c)—see paragraph 9.24.

Q17 (b)—see paragraph 9.18A.

If control is lost, any retained interest in the former subsidiary is measured at fair value, not historical cost.

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements in Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Accounting Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those on pages 115–117 and 121–123.

Case study 1

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

Statements of financial position at 1 January 20X1

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

In this case study, the carrying amounts of SME B's assets and liabilities at 1 January 20X1 approximate their respective fair values. For simplicity, tax has been ignored.

Statements of financial position at 31 December 20X1

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

Statements of comprehensive income for 20X1

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

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

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

Assume that management's best estimate of useful life is 10 years and that SME A uses the straight-line amortisation method for goodwill.

Answer to Case study 1

PART A

Consolidated statement of financial position at 1 January 20X1

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

^(a) Working for goodwill:

Consideration transferred for the business combination	CU900
Fair value of identifiable net assets acquired	
Assets acquired at fair value (CU1,250) – trade liabilities at fair value (CU450)	CU800
Goodwill	<u>CU100</u>

PART B

Consolidated statement of financial position at 31 December 20X1

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

^(a) Working for goodwill:

Goodwill (CU90) = goodwill at the acquisition date (CU100) – accumulated amortisation (CU100 ÷ 10 years).

^(b) Retained earnings adjustment:

CU210 = adjustment at the acquisition date (CU200) + amortisation of goodwill (CU10).

Consolidated statement of comprehensive income for 20X1

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

Case study 2

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

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

The following journal entries are processed by SMEs A and B during 20X1 to recognise the transaction:

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

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

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

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

SME B*1 January 20X1*

Dr	Asset—inventory	2,000	
	Cr	Asset—cash	2,000

During 20X1

Dr	Asset—cash	1,200	
	Cr	Income—revenue	1,200
Dr	Expense—cost of sales	1,000	
	Cr	Asset—inventory	1,000
Dr	Expense—income tax	40	
	Cr	Liability—current tax	40

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

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

		CU	CU
SME A			
<i>1 January 20X1</i>			
Dr	Asset—property, plant and equipment (PPE)	100,000	
	Cr	Asset—cash	100,000
<i>31 December 20X1</i>			
Dr	Expense—depreciation	5,000	
	Cr	Asset—PPE	5,000
SME B			
<i>1 January 20X1</i>			
Dr	Asset—cash	100,000	
	Cr	Asset—PPE	80,000
	Cr	Income—profit on sale of PPE	20,000
Dr	Expense—income tax	4,000	
	Cr	Liability—current tax	4,000

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

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

		<i>CU</i>	<i>CU</i>
SME A			
Dr	Asset—trade receivable	5,000	
	Cr Income—operating lease		5,000
Dr	Expense—income tax	1,000	
	Cr Liability—current tax		1,000
SME B			
Dr	Expense—operating lease	5,000	
	Cr Liability—trade payable		5,000
Dr	Asset—deferred tax	1,000	
	Cr Expense—income tax		1,000

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

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

		<i>CU</i>	<i>CU</i>
SME A			
Dr	Asset—cash	50,000	
	Cr Income—dividends		50,000
SME B			
Dr	Equity—retained earnings	50,000	
	Cr Asset—cash		50,000

Based on the intercompany transactions detailed in this case study, prepare the consolidation adjustments necessary to prepare the group's 31 December 20X1 consolidated financial statements and explain the reasons for any adjustments.

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

Answer to Case study 2

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

	CU	CU
Dr Income—revenue	10,000	
Cr Expense—cost of sales		8,000
Cr Asset—inventory		2,000
Dr Asset—deferred tax	400	
Cr Expense—income tax		400

To eliminate the intragroup sale of goods and related tax effect.

These adjustments eliminate the effect of the intragroup sale of inventory. No party outside the group was involved in the transaction, so no sale is presented in the consolidated financial statements.

The CU2,000 difference between the amount of inventory recognised by SME A in its own records (CU10,000) and the amount recognised in the consolidated financial statements (CU8,000) is a deductible temporary difference (see Section 29 *Income Tax* of the *IFRS for SMEs* Accounting Standard) and it gives rise to a deferred tax asset of CU400 ($20\% \times \text{CU}2,000$) and a corresponding decrease in income tax expense. If the inventory is sold by the group to a third party in the future, this temporary difference will reverse and the related tax expense will ultimately be recognised. At that point, the CU2,000 profit will also be recognised.

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

SME A	CU	CU
Dr Income—revenue	2,000	
Cr Expense—cost of sales		1,800
Cr Asset—inventory		200
Dr Asset—deferred tax	40	
Cr Expense—income tax		40

To eliminate the intragroup sale of goods and related tax effect.

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

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

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

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

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

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

To eliminate the intragroup profit on sale of PPE and the additional depreciation expense recognised and related taxation effects.

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

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

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

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

		CU	CU
Dr	Liability—trade payable	5,000	
	Cr Asset—trade receivable		5,000
Dr	Income—operating lease	5,000	
	Cr Expense—operating lease		5,000

To eliminate the intragroup operating lease.

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

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

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

To eliminate the intragroup dividends.

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



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