Sample Barry Smith ACCA F7 notes

IAS 27

Group accounts – IAS 27

1. Objective of a consolidation process

Where P is and individual legal entity and S is an individual legal entity, if P controls S, then in substance they form a single economic entity. This is referred to as a group.

The essential feature of a group is that one entity controls all the others.

Financial statements are prepared as if they are the accounts of a single entity.

IAS 27 applies to the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent.

IAS 27 also applies to the accounting for investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of a parent.

Illustrative example of consolidating statements of financial position

Statement of financial position	**parent**	**subsidiary**	**adjust**	**group**
Assets				
Investment in subsidiary (100%)	40,000		(40,000)	0
Other assets	58,000	40,000		98,000
	98,000	**40,000**	**(40,000)**	**98,000**
Liabilities	14,000			14,000
Equity				
Ordinary share capital	70,000	40,000	(40,000)	70,000
Reserves	14,000			14,000
	98,000	**40,000**	**(40,000)**	**98,000**

The parent investment is in the equity of the subsidiary. From the perspective of the individual reporting entities, the parent investment and the subsidiary equity arise from transactions with parties that are outside each reporting entity. However, from a group perspective, the parent and subsidiary are, in substance, part of the same reporting entity so there is no transaction with an external party. For this reason, the parent investment is cancelled against the subsidiary investment.

2. Definitions

Parent: An entity that has one or more subsidiaries.

Subsidiary: An entity that is controlled by a parent.

Group: A parent and all its subsidiaries.

Consolidated financial statements: The financial statements of a group presented as those of a single entity.

Control: The power to govern financial and operating policies so as to obtain benefits from its activities. For exam purposes, control is reasonably presumed (in the absence of other information) if the parent has 50% or more of the voting power.

Control may also be evident from power to:

- Govern the financial and operating policies under statute or agreement
- Appoint or remove the majority of the board of directors
- Cast the majority of votes at meetings of the board of directors

Potential voting rights that are currently exercisable through share warrants, options or convertible debt or equity instruments should be taken into consideration when assessing one entity controls another.

Non-controlling interest: The equity in a subsidiary that is **not** attributable, directly or indirectly, to a parent.

Separate financial statements: Financial statements presented by a parent in which the investments are accounted for on the basis of direct equity interest rather than on consolidated basis i.e. reported results and nets assets of the subsidiaries.

3. Requirement to prepare consolidated financial statements

A parent is required to prepare consolidated financial statements in accordance with requirements of IAS 27 except if all of the following apply:

- Parent is itself 100% subsidiary or parent is partially owned by another entity and owners do not object to the parent not preparing consolidated financial statements
- Parent's debt or equity instruments are not publicly traded
- Parent has not filed nor is in the process of filing financial statements with a securities commission for the purpose of going public
- Ultimate or intermediate parent produces consolidated financial statements in accordance with IFRS and are available for public use.

A parent that, based on the above possibilities, elects not to produce consolidated financial statements, presents only separate financial statements in accordance with IAS 27.

4. Exclusion of subsidiary from consolidation

If consolidated accounts are to be prepared, then all subsidiaries must be included except if:

- There is a loss of effective control (account for the investment in accordance with IAS 39); or
- The subsidiary is acquired but is to be immediately re-sold (account for the investment in accordance with IFRS 5)

5. Co-terminus period ends

IAS 27 permits use of financial statements made up to a date not more than three months earlier or later than the parent's reporting date. Adjustments are required for significant transactions or events between the dates.

6. Uniform accounting policies

All group entities should have the same accounting policies. Where necessary, financial statements of group member must be adjusted to achieve consistency of accounting treatment within the group accounts.

7. Consolidation procedures

(i) Parent and subsidiaries are combined on a line by line basis for income, expenses, assets, liabilities and equity. Parent's investment in each subsidiary and the corresponding equity in each subsidiary are eliminated.

Illustrative example of a consolidation

Parent acquires 100% of Subsidiary on date of incorporation of Subsidiary at the nominal value of Subsidiary's ordinary share capital. There are no transactions between Parent and Subsidiary other than the investment by Parent in Subsidiary.

Statement of comprehensive income	**parent**	**subsidiary**	**adjust**	**group**
Income	10,000	2,000		12,000
Expenses	4,000	400		4,400
Profit for the period	**6,000**	**1,600**		**7,600**

The group amounts are the sum of the Parent and Subsidiary amounts on a line by line basis. The parent's investment in Subsidiary is eliminated against Subsidiary equity.

Statement of financial position	**parent**	**subsidiary**	**adjust**	**group**
Assets				
Investment in subsidiary (100%)	40,000		(40,000)	0
Other assets	58,000	41,600		99,600
	98,000	**41,600**	**(40,000)**	**99,600**
Liabilities	14,000			14,000
Equity				
Ordinary share capital	70,000	40,000	(40,000)	70,000
Reserves	14,000	1,600		15,600
	98,000	**41,600**	**(40,000)**	**99,600**

(ii) Intragroup balances and transactions are eliminated.

Illustrative example of the elimination of intragroup balance and transactions

Parent acquires 100% of Subsidiary on date of incorporation of Subsidiary at the nominal value of Subsidiary's ordinary share capital. Parent invoices €200 of goods to Subsidiary during the current reporting period. Amounts are due to/from Parent/Subsidiary at the reporting date. There is no inventory on hand at the reporting date.

Statement of comprehensive income	**Parent**	**Subsidiary**	**adjust**	**group**
Income from subsidiary	200		(200)	0
Other income	9,800	2,000		11,800
Income	**10,000**	**2,000**	**(200)**	**11,800**
Expenses charged by Parent		200	(200)	0
Other expenses	4,000	200		4,200
Expenses	**4,000**	**400**	**(200)**	**4,200**
Profit for the period	**6,000**	**1,600**	**0**	**7,600**

The intra-group income, expenses, receivables and payables are eliminated in full.

Statement of financial position	**Parent**	**Subsidiary**	**adjust**	**group**
Assets				
Investment in subsidiary (100%)	40,000		(40,000)	0
Trade receivable from Subsidiary	10,000		(10,000)	0
Other assets	48,000	51,600		99,600
	98,000	**51,600**	**(50,000)**	**99,600**
Liabilities				
Trade payable to Parent		10,000	(10,000)	0
Other liabilities	14,000			14,000
	14,000	10,000	(10,000)	14,000
Equity				
Ordinary share capital	70,000	40,000	(40,000)	70,000
Reserves	14,000	1,600		15,600
	98,000	**51,600**	**(50,000)**	**99,600**

(iii) Unrealised intragroup profits are eliminated.

Illustrative example of the elimination of unrealised profit arising from intragroup trading of inventory

Parent acquires 100% of Subsidiary on date of incorporation of Subsidiary at the nominal value of Subsidiary's ordinary share capital. Parent sells goods to Subsidiary during the current reporting period. The invoice price is €200. Parent's profit on the transaction is €100. All this inventory is still on hand in accounts of Subsidiary at reporting date. There were no amounts due to/from Parent/Subsidiary at the reporting date.

Statement of comprehensive income	**Parent**	**Subsidiary**	**adjust**	**group**
Income from subsidiary	200		(200)	0
Other income	9,800	2,000		11,800
Income	**10,000**	**2,000**	**(200)**	**11,800**
Purchase of inventory	2,000	200	(200)	2,000
Less closing inventory		(200)	100	(100)
Cost of sales	**2,000**	**0**	**(100)**	**1,900**
Other expenses	2,000	200		2,200
Expenses	**2,000**	**200**	**0**	**2,200**
Profit for the period	**6,000**	**1,800**	**(100)**	**7,700**

The intragroup sales are purchases are eliminated. The closing inventory valuation is adjusted to reflect the cost of the inventory to the group. The cost to the group is the cost of inventory at the point at which it entered the group – this occurred when Parent purchased the inventory.

Statement of financial position	**Parent**	**Subsidiary**	**adjust**	**group**
Assets				
Investment in subsidiary (100%)	40,000		(40,000)	0
Inventory		200	(100)	100
Other assets	58,000	41,600		99,600
	98,000	**41,800**	**(40,100)**	**99,700**
Liabilities	14,000			14,000
Equity				
Ordinary share capital	70,000	40,000	(40,000)	70,000
Reserves	14,000	1,800	(100)	15,700
	98,000	**41,800**	**(40,100)**	**99,700**

Illustrative example of the elimination of unrealised profit arising from intragroup transfer of a noncurrent asset

Parent acquires 100% of Subsidiary on date of incorporation of Subsidiary at the nominal value of Subsidiary's ordinary share capital. At the beginning of the current reporting period, Parent sells a noncurrent asset with a carrying value of €24,000 to Subsidiary for €30,000. At the end of the current reporting period, subsidiary depreciates the noncurrent asset using a 10% straight-line method. . There were no amounts due to/from Parent/Subsidiary at the reporting date.

The consolidation is as follows:

Statement of comprehensive income	**parent**	**subsidiary**	**adjust**	**group**
Income	10,000	7,500		17,500
Profit on disposal of asset	6,000		(6,000)	
Depreciation		(3,000)	600	(2,400)
Other expenses	(4,000)	(400)		(4,400)
Profit for the period	**12,000**	**4,100**	**(5,400)**	**10,700**

Parent's profit on disposal of €6,000 is the difference between the proceeds of sale (€30,000) and the carrying value at the date of disposal (€24,000). Because the sale of the noncurrent asset is to another group entity, the profit on disposal is unrealised. It must therefore be reversed.

Statement of financial position	**parent**	**subsidiary**	**adjust**	**group**
Assets				
Noncurrent asset		27,000	(5,400)	21,600
Investment in subsidiary (100%)	40,000		(40,000)	
Other assets	58,000	25,000		83,000
	98,000	**52,000**	**(45,400)**	**104,600**
Liabilities	14,000			14,000
Equity				
Ordinary share capital	70,000	40,000	(40,000)	70,000
Reserves	14,000	12,000	(5,400)	20,600
	98,000	**52,000**	**(45,400)**	**104,600**

The depreciation charge of €3,000 is based on a depreciable amount of €30,000. However, the depreciation charge in the consolidation should be based on the depreciable cost to the group, which is €24,000. In other words, depreciation should be based on the cost incurred at the point at which the noncurrent asset entered the group – this occurred when Parent acquired the asset. On this basis, the correct depreciation charge for the group is €2,400 (€24,000 x 10%). An adjustment of €600 is therefore required to reduce the amount of the depreciation charge.