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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

CL-25-1 | Corporate Financial Reporting

Corporate Level (2025 – Curriculum)

- Consolidated Financial Statements – Part 1

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1. INTRODUCTION TO GROUP ACCOUNTS

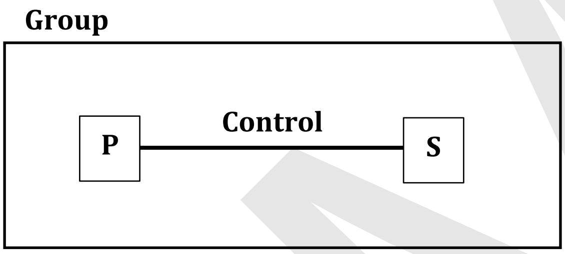
There are many **reasons** for one company to buy shares in another.

- A company may acquire shares in a supplier to ensure continued supply
- A company may buy shares in a customer to secure a distribution network
- To achieve geographical expansion or to enter a new market
- A company may buy shares in a competitor to access its products or know how
- There may be tax or legal reasons for an acquisition

1.1 RELAVANT ACCOUNTING STANDARDS

- SLFRS 3 Business Combinations
- SLFRS 10 Consolidated Financial Statements
- LKAS 27 Separate Financial Statements
- LKAS 28 Investments in Associates and Joint Ventures
- SLFRS 11 Joint Arrangements
- SLFRS 12 Disclosure of Interests in Other Entities

1.2 SINGLE ECONOMIC ENTITY CONCEPT

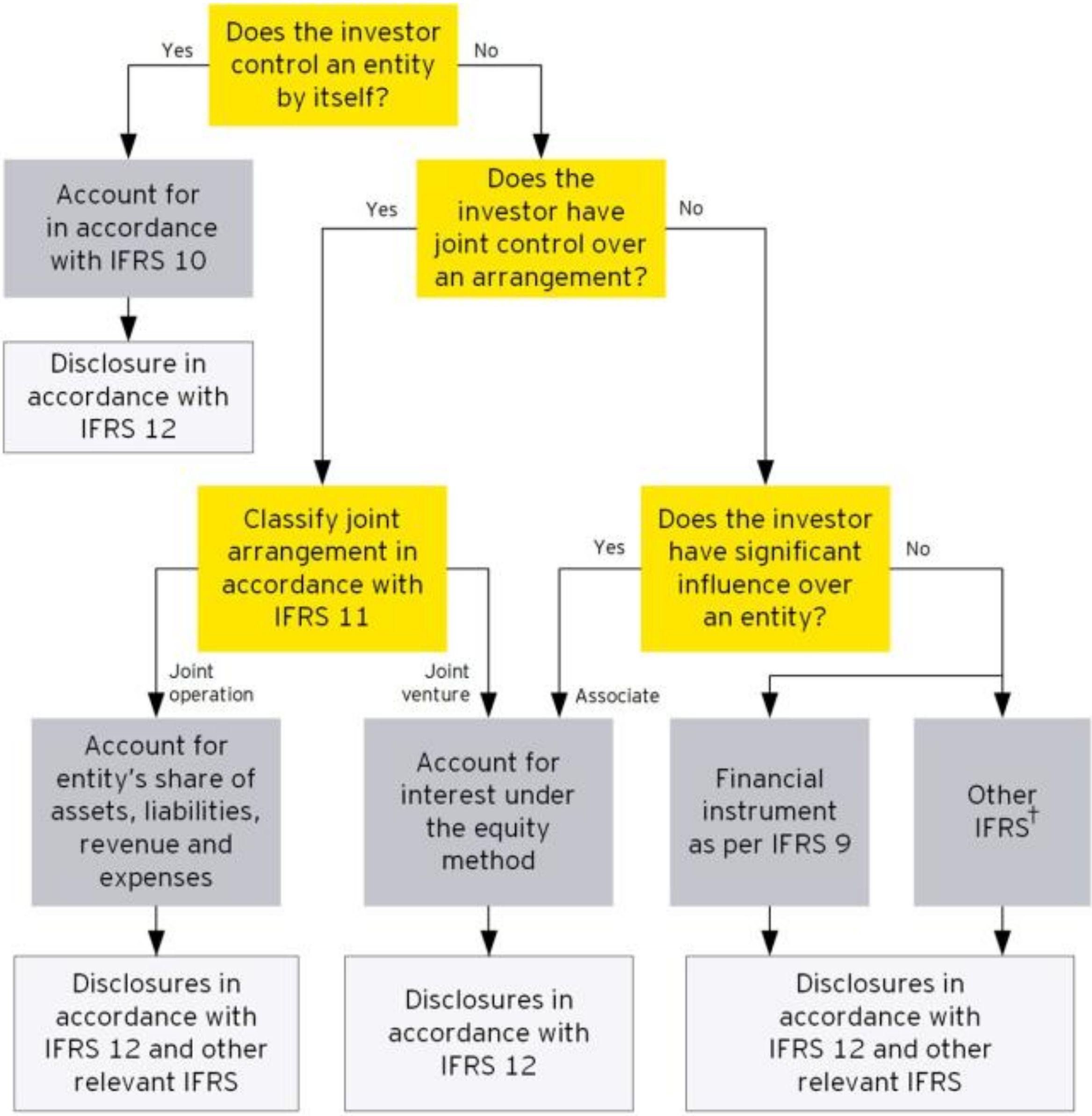


- P is an individual **legal entity**
- S is an individual **legal entity**
- P controls S and therefore they form a **single economic entity – the Group**

The purpose of consolidated accounts is to:

- Present financial information about a parent undertaking and its subsidiary undertakings as a single economic unit
- Show the economic resources controlled by the group
- Show the obligations of the group
- Show the results the group achieves with its resources.

1.3 INTEREST IN OTHER ENTITIES – SUMMARY



1.4 DEFINITIONS

Term	Definition
Group	A group is a parent and all of its subsidiaries
Parent	A parent is an entity that controls one or more subsidiaries
Subsidiary	A subsidiary is an entity that is controlled by another entity (known as the parent) .
Control	an investor controls an investee when; • the investor has **power** over the investee • the investor is exposed, or has rights, to **variable returns** from its involvement with the investee • the investor has the **ability to affect** those returns through its power over the investee

Power	Existing rights that give the current **ability to direct** the relevant activities of the investee
Associate	An associate is an entity over which an investor has **significant influence** that is neither a subsidiary nor a joint venture.
Significant influence	Significant influence is the **power to participate** in the financial and operating policy decisions of an investee but is not control or joint control over those policies.
Joint Arrangement	A joint arrangement is an arrangement of which two or more parties have joint control.
Joint Control	Joint control is the **contractually agreed sharing of control** of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.
Joint Venture	A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

1.5 ACCOUNTING TREATMENT - SUMMARY

Type of share Investment	Criteria to be checked	Required accounting treatment in Group Accounts
Subsidiary	Control	Full Consolidation (SLFRS 10)
Associate	Significant Influence	Equity method of accounting (LKAS 28)
Join Ventures	Joint Control	Equity method of accounting (LKAS 28)
Normal Investments	Assets held of appreciation of wealth or dividend income	As a financial Asset (SLFRS 9)

1.6 CONTROL

Consolidated financial statements should be prepared when the parent company has control over the subsidiary *(for examination purposes control is usually established based on ownership of more than 50% of voting power).*

An investor controls an investee if, and only if, it has all of the following:

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

Power (as defined above) **can be obtained** directly from ownership of the majority of voting rights or can be derived from other rights, such as:

- Rights to appoint, reassign or remove key management personnel who can direct the relevant activities
- Rights to appoint or remove another entity that directs the relevant activities
- Rights to direct the investee to enter into, or veto changes to, transactions for the benefit of the investor
- Other rights, such as those specified in a management contract

SLFRS 10 states that investors should periodically consider whether control over an investee has been gained or lost and goes on to consider that a range of **circumstances may need to be considered when determining whether or not an investor has power over an investee**, such as:

- Exercise of the majority of voting rights in an investee
- Contractual arrangements between the investor and other parties holding less than 50% of the voting shares, with all other equity interests held by a numerically large, dispersed and unconnected group (de-facto control)
- Potential voting rights (such as share options or convertible loans) may result in an investor gaining or losing control at some specific date

Potential Voting Rights

An entity may own share warrants, share call options, or other similar instruments that are convertible into ordinary shares in another entity. If these are exercised or converted they may give the entity voting power or reduce another party's voting power over the financial and operating policies of the other entity (potential voting rights). The existence and effect of potential voting rights, including potential voting rights held by another entity, should be considered when assessing whether an entity has control over another entity (and therefore has a subsidiary). Potential voting rights are considered only if the rights are substantive (meaning that the holder must have the practical ability to exercise the right).

In assessing whether potential voting rights give rise to control, the investor should consider the purpose and design of the instrument. This includes an assessment of the various terms and conditions of the instrument as well as the investor's apparent expectations, motives and reasons for agreeing to those terms and conditions.

Test Your Understanding 01

1. **Which of the following definitions is not included within the definition of control per SLFRS 10?**
   A. Having power over the investee
   B. Having exposure, or rights, to variable returns from its investment with the investee
   C. Having the majority of shares in the investee
   D. Having the ability to use its power over the investee to affect the amount of the investor’s returns

2. **Which of the following situations is unlikely to represent control over an investee?**
   A. Owning 55% and being able to elect 4 of the 7 directors
   B. Owning 51 %, but the constitution requires that decisions need the unanimous consent of shareholders
   C. Having currently exercisable options which would take the shareholding of the company to 55%

D. Owning 40% of the shares, but having the majority of voting rights within the company

3. **Sithara Ltd acquired 80% of Nishara Ltd. on 01st April 2020. On 01st March 2022, Nishara Ltd. acquired 55% of Divya Ltd. In order to expand the business Sithara Ltd. further made a 10% direct investment in Divya Ltd. and 50% in Mihika Ltd on 31st March 2022. Which of the following is/are subsidiary/ies of Sithara Ltd as at 31st March 2022.**

A. Nishara Ltd, Divya Ltd and Mihika Ltd
B. Nishara Ltd and Divya Ltd
C. Nishara Ltd and Mihika Ltd
D. Nishara Ltd

4. **According to SLFRS 03, "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 of the investee " is known as:**

A. Power
B. Significant Influence
C. Control
D. Joint Control

5. **Which one of the following is not a principal criterion for consolidation?**

A. Power over the investee arising from voting rights or contractual arrangements.
B. Exposure or right to variable returns from its involvement with the investee.
C. The ability to use its power over the investee to affect the amount of the investor's returns.
D. Power to participate in the financial and operating policy decisions of an investee.

1.7 LKAS 27 SEPARATE FINANCIAL STATEMENTS

A **parent company** will usually produce its own, **single company financial statements**. LKAS 27 Separate Financial Statements provides accounting guidance to be applied in the preparation of these single company financial statements.

In these single company financial statements, investments in subsidiaries, joint ventures and associates should be either:

- Accounted for at cost, or
- In accordance with SLFRS 9 as a financial asset, or
- Using the equity method described in LKAS 28

The same accounting must be applied to each category of investments.

Where subsidiaries are classified as held for sale in accordance with SLFRS 5, they should be accounted for in accordance with SLFRS 5 in the parent's separate financial statements.

1.8 SLFRS 10 - CONSOLIDATED FINANCIAL STATEMENTS

Consolidated financial statements are 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**.

When a parent issue consolidated financial statements, it should consolidate **all** subsidiaries, both foreign and domestic.

However, the directors of a parent company may not wish to consolidate some subsidiaries due to:

- Poor performance of the subsidiary
- Poor financial position of the subsidiary
- Differing activities of the subsidiary from the rest of the group.

These **reasons are not permitted** under SLFRS Standards.

1.9 EXEMPTION FROM PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

A parent need not present consolidated financial statements in the following circumstances: .

01.If, and only if, all of the following hold.

- The parent is itself a wholly owned subsidiary or it is a partially owned subsidiary of another entity (Intermediate Parent) and 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 securities are not publicly traded
- It is not in the process of issuing securities in public securities markets
- The ultimate or intermediate parent publishes consolidated financial statements that comply with SLFRS

A parent that **does not present consolidated financial statements** because it meets these criteria must comply with the LKAS 27 rules on separate financial statements and **shall disclose following information**. ***(Disclosures for non-consolidation)***

- The fact that consolidated financial statements have not been presented
- a list of significant investments (subsidiaries, associates etc.) including percentage shareholding, principal place of business and country of incorporation
- the bases on which those investments listed above have been accounted for in its separate financial statements.

02. The parent company is an **investment entity** that is required to measure its Subsidiaries at fair value through profit or loss.

An **investment entity** is an entity that:

- Obtains funds from one or more investors for the purpose of providing those investors with investment management services;
- Commits to its investors that its business purpose is to invest funds solely for returns from capital appreciation, investment income or both; and

- Measures and evaluates the performance of substantially all of its investments on a fair value basis.

Examples: Private equity organizations, venture capital organizations and other investment funds.

The consolidation of investees by this type of investor **does not result in useful information**. Therefore, SLFRS 10 requires that investment subsidiaries are measured at fair value through profit or loss instead.

1.10 EXCLUSION OF A SUBSIDIARY FROM CONSOLIDATION

SLFRS 10 and LKAS 27 do not specify any other circumstances when subsidiaries must be excluded from consolidation. However, there may be **specific circumstances** that merit particular consideration as follows:

01.Subsidiary held for resale

- If on acquisition a subsidiary meets the criteria to be classified as 'held for sale' in accordance with SLFRS 5, then it must still be included in the consolidation but accounted for as per SLFRS 5.
- In this circumstance the parent has clearly not acquired the investment with a view to long-term control of the activities, hence the logic of the exclusion

02.Materiality

- Usually if a subsidiary is not material to the group performance, then no need to be consolidated.
- However, If a subsidiary is excluded due to immateriality, the case must be reviewed from year to year, and the parent would need to consider each subsidiary to be excluded on this basis, both individually and collectively.

Reason for exclusion	Accounting Treatment
Subsidiary held for sale	Held as a current asset at lower of its carrying amount and the fair value less cost of disposal
Being not material	Accounting standards do not apply to immaterial items. Therefore an immaterial item need not be consolidated.

Test Your Understanding 02

1. **Which one of the following is NOT a condition which must be met for the parent to be exempt from producing consolidated financial statements?**

   A. The activities of the subsidiary are significantly different to the rest of the group and to consolidate them would prejudice the overall group position
   B. The ultimate parent company produces consolidated financial statements that comply with IFRS Standards and are publicly available
   C. The parent's debt or equity instruments are not traded in a public market
   D. The parent itself is a wholly-owned subsidiary or a partially owned subsidiary whose owners do not object to the parent not producing consolidated financial statements

1.11 DIFFERENT REPORTING DATES

In most cases, all group companies will prepare accounts for the same reporting date. One or more subsidiaries may, however, prepare accounts on a different reporting date from the parent and the other subsidiaries in the group.

In such cases, the **subsidiary may prepare additional statements as at the reporting date** of the rest of the group, for consolidation purposes. If this is not possible, the subsidiary's accounts may still be used for the consolidation, provided that:

- The **gap** between the reporting dates is three months or less
- **Adjustments** are made for the effects of significant transactions or other events that occur between the reporting dates

1.12 UNIFORMITY OF ACCOUNTING POLICIES

Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances.

Adjustments must be made where members of a group use different accounting policies, so that their financial statements are suitable for consolidation.

Test Your Understanding 03

1. **Which one of the following statements regarding consolidated financial statements is correct?**

   A. For consolidation, it may be acceptable to use financial statements of the subsidiary if the year-end differs from the parent by 2 months
   B. For consolidation, all companies within the group must have the same year-end
   C. All companies within a group must have the same accounting policy in their individual financial statements
   D. Only 100% subsidiaries need to be consolidated

2. **Petre owns 100% of the share capital of the following companies. The directors are unsure of whether the investments should be consolidated into the group financial statements of not. Identify whether the following companies should be consolidated or not.**

Company	Consolidated/Not Consolidated
Beta is a bank and its activity is so different from the engineering activities of the rest of the group that it would be meaningless to consolidate it.	
Delta is located in a country where local accounting standards are compulsory and these are not compatible with IFRS Standards used by the rest of the group.	
Gamma is located in a country where a military coup has taken place and Petre has lost control of the investment for the foreseeable future.	

The following scenarios are unrelated:

1. AB Co and CD Co establish XY Co, each holding 50% of the voting shares. The shareholders' agreement specifies that:
   (a) XY Co exists to generate capital gains from property investment; its activities are limited to buying, managing and selling investment properties.
   (b) All decisions about major capital activities require the agreement of both investors.
   (c) AB Co is responsible for day to day management activities of XY Co such as negotiating rental agreements, collecting rent and property maintenance. AB Co is paid for these services on the basis of costs plus a fixed margin.

2. HJ Co holds 48% of the ordinary shares in KL Co. KL Co's relevant activities are directed by voting rights conferred by ordinary shares. The remaining 52% of the shares are owned by hundreds of unrelated investors, none of whom own more than 1% individually. There are no arrangements for the other shareholders to consult one another or act collectively and past experience indicates that few of the other owners exercise their voting rights at all.

3. EF Bank establishes a special purpose vehicle SP and owns 100% of its shares. SP simultaneously enters into a trade receivables factoring agreement with PQ Co. This is the sole purpose of SP. An agreement sets out the terms on which SP will purchase PQ Co's receivables and EF Bank will provide financing for that purpose. PQ Co will continue to be responsible for collecting and managing the receivables and it is required to provide a guarantee that losses on the transferred receivables will not exceed a certain amount. The shares held by EF Bank confer voting rights but cannot override the restriction on SP's activities or invalidate the contract with PQ Co.

4. RS Co holds 40% of the equity shares of XY Co and has an option to acquire a further 30% shareholding from MN Co. XY Co is controlled by shareholder vote and there are no other contractual or non-voting rights that affect assessment of control. RS Co's option was acquired recently and is exercisable at any time over the next two years. The exercise price is fixed and the fixed price exceeds the current fair value of the underlying shares by 30%. The fair value of the underlying shares is expected to increase substantially over the coming two years. It is RS Co's intention to acquire the ability to control XY Co.

Required

Discuss whether control is established in each of these scenarios