**International Accounting Standard 27 (IAS 27), Consolidated and Separate Financial Statements**

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*This article is part of a series by the Friedrichs and Stephen Spector on the move to International Financial Reporting Standards to be published on PD Net.*

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*Note that IFRS 1 First-time Adoption of IFRS contains certain elective exemptions for business combinations that occur prior to the entity’s IFRS transition date (January 1, 2010 for most publicly accountable Canadian businesses). Business combinations occurring after this date must be accounted for under IFRS 3. Also, while Section 1582 takes effect January 1, 2011, paragraph .67B states that an entity making the transition to IFRSs in 2011 will be required to show comparative information for any business combinations completed during the preceding fiscal year measured and presented in accordance with IFRS 3 and IAS 27. Consequently, an entity contemplating a business combination might (should? will?) choose to adopt that section as of the beginning of its fiscal year beginning on or after January 1, 2010 to minimize the effect of making the transition. Finally, an entity adopting section 1582 in 2010 will also have to adopt sections 1601 and 1602.*

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Overview of IAS 27

The January 2008 revisions to IAS 27 are closely related to the revisions to IFRS 3 Business Combinations. IAS 27 also makes reference to IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures; however, these sections are beyond the scope of this series of articles. Moreover, IAS 31 is expected to be replaced by the end of 2009.

Objective

The objective of IAS 27 is to enhance the relevance, reliability, and comparability of the information contained in:

- consolidated financial statements that a parent prepares for the group of entities it controls; and
- separate (non-consolidated) financial statements that a parent, investor, or venturer elects to provide, or is required by local regulation to provide.

The standard specifies the circumstances in which consolidated financial statements are required, as well as providing guidance on the required accounting for changes in ownership levels, including changes that result in the loss of control of a subsidiary. IAS 27 also includes requirements for disclosure of information to allow financial-statement users to evaluate the nature of the relationship between the parent entity and its subsidiaries.

Scope

IAS 27 is applied in the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent. In addition, when an entity presents separate financial statements (by choice or to comply with local regulations), the standard must be applied in accounting for the investments in subsidiaries, jointly controlled entities, and associates.

IAS 27 does not deal with accounting for business combinations; IFRS 3 Business Combinations covers this topic.

Highlights of the standard

Definitions

Paragraph 4 provides definitions for the following key terms (among others):

- **Consolidated financial statements** are the financial statements of a group presented as those of a single economic entity.

- **Control** is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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

- **Separate financial statements** are those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

- **A Subsidiary** is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).
Note that the definition of “control” differs from the current CICA Handbook definition in Section 1590, Subsidiaries, where control is “the continuing power to determine its strategic, operating, investing, and financing policies, without the co-operation of others.” Note also that the IASB released an exposure draft in December 2008 which proposes to replace IAS 27 and refine the definition of control.

Also note that with respect to separate financial statements, paragraph 7 adds “The financial statements of an entity that does not have a subsidiary, associate or venturer’s interest in a jointly controlled entity are not separate financial statements.” In other words, in the context of IAS 27, the term “separate financial statements” only relates to the (non-consolidated) statements of an entity that has an ownership interest in one or more other entities, and does not relate to entities that do not have such interests.

Presentation and scope of consolidated financial statements

IAS 27 requires that an entity that has one or more subsidiaries must present consolidated financial statements (¶9), unless all four of the following conditions are met (¶10):

- the parent is itself a wholly owned subsidiary, or is a partially owned subsidiary of another entity and its other owners do not object to the entity presenting non-consolidated financial statements
- the parent’s debt or equity instruments are not publicly traded
- the parent is not filing its statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market
- the ultimate parent (or any intermediate parent) of the entity produces publicly available consolidated financial statements that are IFRS compliant

If a parent meets these criteria, consolidated financial information is being provided at a higher level by either the ultimate parent or an intermediate parent; consequently, it is not needed at the entity’s level and the reporting entity can elect not to present consolidated financial statements. The entity would then present only separate financial statements in accordance with the guidance for separate statements discussed later in the standard.

Consolidated financial statements are required to include all of the parent’s subsidiaries (¶12). Subsidiaries are identified based on control by the parent. Control is presumed to exist when the parent acquires more than half of the voting rights of another enterprise, but control may also exist solely based on power. Paragraph 13 explains that a parent may control a subsidiary even though the parent owns less than 50% of the voting rights if, for example,

- the parent has power over more than one half of the voting rights as the result of an agreement with other investors; or
- there is a statute or an agreement that allows the parent to govern the financial and operating policies of the subsidiary; or
- the parent can appoint or remove the majority of the members of the board of directors, or can cast the majority of votes at a meeting of the board of directors.

In assessing whether control exists, the entity should also consider any potential voting rights that may come about — for example, as a result of share warrants, share call options, or convertible debt or equity instruments that are owned by the entity.

Consolidation procedures

Consolidated financial statements are prepared by combining the financial statements of the parent and its subsidiaries line by line. At each line, like items of assets, liabilities, equity, income, and expense are added together to present financial information about the group as that of a single economic entity. The income and expenses of a subsidiary are included in the
Paragraphs 18 to 30 provide guidance on consolidation procedures. The requirements aim to ensure relevance, reliability, and comparability of the resulting financial information.

**General guidance**

**During consolidation**

- the carrying amount of the parent’s investment in each subsidiary and the parent’s portion of equity of each subsidiary are eliminated, with any resultant goodwill accounted for as required by IFRS 3 *Business Combinations*
- non-controlling interests in the profit or loss of consolidated subsidiaries for the reporting period are identified
- non-controlling interests in the net assets of consolidated subsidiaries (including the NCI at the original combination date and the NCI’s share of changes in equity since the combination) are identified separately from the parent’s ownership interests in them (¶18)

Intra-group balances, transactions, income, expenses, and dividends are eliminated in full, including profits and losses resulting from intra-group transactions that are recognized in assets (such as inventory and fixed assets). Note that intra-group losses may indicate an impairment that requires recognition in the consolidated financial statements (¶20 and 21).

The parent and subsidiary financial statements that are used in the preparation of the consolidated financial statements should all be prepared as of the same reporting date, even if this means that the subsidiaries prepare extra statements as of the parent’s reporting date, to be used for consolidation purposes. If this is impracticable, adjustments need to be made for significant transactions or events that occur between the date of the subsidiary’s statements and the date of the parent’s statements (¶22 and 23).

If differently dated parent and subsidiary statements are used for consolidation, the difference between the end of the reporting period of the subsidiary and that of the parent must be no more than three months, regardless of any adjustments made. Furthermore, in the interest of comparability, the length of the reporting periods and any difference between the ends of the parent and subsidiary reporting periods must stay the same from period to period (¶23).

Consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances. If needed, appropriate adjustments are made to the financial statements of the group members to reflect the accounting policies used in preparing the consolidated financial statements (¶24 and 25).

**Non-controlling interests**

Non-controlling interests are presented in the consolidated statement of financial position within equity, but separately from the equity of the owners of the parent (¶27). Rather than showing the non-controlling interest in net income as a deduction in arriving at consolidated net income or other comprehensive income, IAS 27 requires that net income and each component of other comprehensive income be allocated to the controlling interest and the NCI (based on proportion of ownership unless a contractual agreement specifies a different allocation). Total comprehensive income is also attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance (¶28).

Note that if a subsidiary has outstanding cumulative preferred shares that are classified as equity, the parent computes its share of profit or loss after adjusting for the dividends on preferred shares held by non-controlling interests, regardless of whether dividends have been declared (¶29).
Changes in the parent’s ownership – No loss of control

Accounting for changes in a parent’s ownership interest in a subsidiary depends on whether the change results in a loss of control. Changes that do not result in a loss of control are accounted for as equity transactions (¶30). This includes situations where the parent acquires additional shares in the subsidiary after control was obtained, or where the parent sells part of its investment in the subsidiary without losing control.

If the parent purchases additional shares of the subsidiary, it is accounted for as an equity transaction with the owners (conceptually similar to the acquisition of treasury shares). Similarly, if a parent partially disposes of an investment in a subsidiary but retains control, this is accounted for as an equity transaction, and no gain or loss is recognized.

In these situations, the carrying amounts of the controlling and non-controlling interests are adjusted to reflect the changes in their relative percentage interests in the subsidiary. If there is a difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, this difference is recognized directly in equity and attributed to the owners of the parent (¶31).

Changes in the parent’s ownership – Loss of control

Loss of control normally occurs when the parent disposes of part of its investment in the subsidiary, but paragraph 32 notes that a parent can lose control of a subsidiary with or without a change in absolute or relative ownership levels — for example, if a subsidiary becomes subject to the control of a court or regulator, or as a result of a contractual agreement.

If loss of control occurs, the parent goes through the following process (¶34 and 35):

- derecognize the assets, liabilities, and goodwill of the subsidiary at their carrying amounts on the date when control is lost;
- derecognize the carrying amount of any non-controlling interests on the date when control is lost;
- recognize the fair value of any consideration received and any distribution of shares of the former subsidiary;
- recognize any investment retained in the former subsidiary at its fair value on the date when control is lost;
- reclassify to profit or loss (or transfer directly to retained earnings if required in accordance with other IFRSs) the amounts needed to account for all items recognized in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities; and
- recognize any resulting difference in profit or loss, attributable to the parent.

As an example, assume Parent owns 75% of Sub’s voting shares and loses control of Sub by selling 40% of Sub’s shares for $400,000. The fair value of Parent’s remaining investment in Sub is $335,000. At the time of the sale, the carrying amount of the NCI is $220,000, and the carrying amount of Sub’s net assets is $870,000.

Parent’s gain or loss would be calculated as follows (assume there are no previously recognized items to reclassify to profit or loss):

\[ \text{Gain or Loss} = (\text{Fair Value of Parent’s Remaining Investment} - \text{Carrying Amount of NCI}) - (\text{Carrying Amount of Sub’s Net Assets} - \text{See-Sale Price}) \]

\[ = (335,000 - 220,000) - (870,000 - 400,000) \]

\[ = 115,000 - 470,000 \]

\[ = -355,000 \]

Parent’s loss would be $355,000.

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1 As an example, suppose a subsidiary has available-for-sale financial assets and the parent loses control of the subsidiary. The parent is required to reclassify to profit or loss the gain or loss that was previously recognized in other comprehensive income in relation to those assets (¶35).
Proceeds of sale of 40% investment $ 400,000
Fair value of retained 35% investment 335,000
Carrying amount of NCI at time of sale 220,000

Less: Carrying amount of Sub’s net assets at time of sale (870,000)
Gain recognized by Parent $ 85,000

After accounting for the loss of control, IAS 28 Investments in Associates, IAS 31 Interests in Joint Ventures, or IAS 39 Financial Instruments: Recognition and Measurement, as appropriate, is applied to the remaining holding (¶36).

Paragraph 33 notes that the control of a subsidiary may be lost over two or more transactions. In some cases, however, IAS 27 requires these multiple transactions to be accounted for as a single transaction, based on the terms and conditions of the arrangements and their economic effects. If, for example, the transactions are entered into at the same time or in contemplation of each other, this may be an indication that the parent should account for the multiple arrangements as a single transaction.

The same situation may arise if multiple transactions are interdependent, or were designed to achieve an overall commercial effect, or if the transactions must be considered together in order to be economically justifiable (for example, if a disposal of shares priced below market is compensated for by a subsequent disposal priced above market). The requirement to recognize the economic substance of a single transaction is meant to remove the potential motivation for an entity to structure a transaction or arrangement as multiple steps to maximize gains (or minimize losses) when disposing of its controlling interest in a subsidiary.

**Accounting for investments in subsidiaries, jointly controlled entities, and associates in separate financial statements**

When an entity prepares separate financial statements, IAS 27 provides a choice in how to account for investments in subsidiaries, jointly controlled entities, and associates. These investments can be accounted for either at cost or in accordance with IAS 39 Financial Instruments: Recognition and Measurement.

For consistency, the entity is required to apply the same accounting for each category of investments. Investments accounted for at cost that are classified as held for sale (or included in a disposal group that is classified as held for sale) should be accounted for in accordance with IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations. However, financial assets that an entity accounts for in accordance with IAS 39 are excluded from IFRS 5’s measurement requirements. Dividends from a subsidiary, jointly controlled entity, or associate are to be recognized in profit or loss in the entity’s separate financial statements when the entity’s right to receive the dividend is established (¶38 and 38A).

Note that, for first-time implementation of IFRS, IFRS 1 allows an option to use a deemed cost of either fair value or the carrying amount under the previous accounting practices to measure the initial cost of investments in subsidiaries, jointly controlled entities, and associates in the separate financial statements. This addresses concerns that, for first-time adopters, retrospectively determining cost and applying the cost method cannot, in some circumstances, be achieved without undue cost or effort.

IAS 27 also provides specific guidance to address the situation where a parent reorganizes the structure of its group by establishing a new entity as its parent. If the reorganization fits the specific criteria in paragraph 38B (for example, the new parent must obtain control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent), IAS 27 requires the new parent to measure the cost of its investment in the previous parent at the carrying amount of its share of the equity items of the previous parent at the date of the reorganization.
When a subsidiary prepares separate financial statements, paragraph 40 of IAS 27 requires that investments in jointly controlled entities and associates accounted for in accordance with IAS 39 Financial Instruments: Recognition and Measurement in the consolidated financial statements be accounted for in the same way in the entity’s separate financial statements.

**Presentation and disclosure**

IAS 27 requires disclosure of information regarding the nature of the relationship between the parent entity and its subsidiaries. Disclosure requirements are divided into three categories:

**Disclosures required in consolidated financial statements (¶41)**
- the nature of the relationship between the parent and a subsidiary when the parent does not directly or indirectly own more than half of the voting power (for example, explaining how control has been determined)
- justification in cases where an entity directly or indirectly owns more than half of the voting or potential voting power of an investee but this ownership does not constitute control
- the reporting date of the financial statements of a subsidiary when they are using a reporting date or period that is different from that of the parent, along with the reason for the use of different dates (for example, justifying why it was impracticable to prepare all statements as of the same date)
- the nature and extent of any significant restrictions on a subsidiary’s ability to transfer funds to the parent in the form of cash dividends or to repay loans or advances
- a schedule showing the effects on the equity attributable to owners of the parent of any ownership changes that do not result in a loss of control
- if control of a subsidiary is lost, specific details on the gain or loss

**Disclosures required in separate financial statements that are prepared for a parent that is permitted not to prepare consolidated financial statements (¶42)**

When separate financial statements are prepared for a parent that meets the criteria in paragraph 10 and elects not to prepare consolidated financial statements, those separate financial statements must disclose
- the fact that the exemption from consolidation has been used and the financial statements are separate rather than consolidated
- the name and country of incorporation or residence of the entity (that is, the ultimate or intermediate parent) whose IFRS-compliant consolidated financial statements have been produced for public use, and the address where those consolidated financial statements are obtainable
- a list of significant investments in subsidiaries, jointly controlled entities, and associates, including the name, country of incorporation or residence, proportion of ownership interest, and (if different) proportion of voting power held
- a description of the method used to account for the investments disclosed

**Disclosures required in the separate financial statements of a parent, investor in a jointly controlled entity, or investor in an associate (¶43)**

When a parent (other than a parent that is permitted not to prepare consolidated financial statements), a venturer with an interest in a jointly controlled entity, or an investor in an associate prepares separate financial statements, those separate financial statements must disclose
- the fact that the statements are separate rather than consolidated, and the reasons why those statements are prepared (if the reason is other than legal requirements)
• a list of significant investments in subsidiaries, jointly controlled entities, and associates, including the name, country of incorporation or residence, proportion of ownership interest, and (if different) proportion of voting power held

• a description of the method used to account for the investments disclosed

Because the separate financial statements do not meet the entity’s reporting requirements (the disclosure requirements in paragraph 43 relate to entities that are not exempt from filing consolidated statements), the entity must also identify the consolidated financial statements that have been prepared to meet IAS 27 (or IAS 28 Investments in Associates or IAS 31 Interests in Joint Ventures, as the case may be).

Differences from Canadian GAAP

With IFRS 3, convergence efforts with respect to business combinations and subsequent reporting are completed. The AcSB replaced section 1581, Business Combinations with a revised section 1582 (still named Business Combinations). It also replaced section 1600, Consolidated Financial Statements with two new sections — section 1601, Consolidated Financial Statements and section 1602, Non-Controlling Interests. These three sections will be mandatory for fiscal years beginning on or after January 1, 2011. With the release of these three sections, almost all of the differences between pre-IFRS Canadian GAAP and the corresponding IFRSs are eliminated.

Differences that currently exist between IAS 27 and Handbook Section 1600 which were eliminated by Handbook Sections 1601 and 1602 centred mainly around accounting for non-controlling interests and the treatment of step acquisitions and partial disposals:

• Under IAS 27, non-controlling interests are presented in the consolidated statement of financial position within equity, as opposed to presentation outside of consolidated shareholders’ equity, as in current Canadian GAAP. Also, rather than showing the non-controlling interest in net income as a deduction in arriving at consolidated net income or other comprehensive income, IAS 27 requires that net income, each component of other comprehensive income, and total comprehensive income be allocated to the controlling interest and the NCI.

• Under IAS 27, increases in ownership after control has been obtained and decreases in ownership where control is retained are handled as capital transactions. This differs from current Canadian GAAP, where each investment tranche results in a separate purchase adjustment and goodwill account, and each decrease in ownership results in a dilution gain or loss.

There are, however, a few differences that remain between the Canadian approach and the IASB version of these standards. This situation is explained as follows in the Exposure Draft for Section 1602:

The AcSB decided against incorporating all of IAS 27 into Canadian GAAP at this time because it did not intend to change any of the following standards that differ from IFRSs:

(a) IAS 27 includes a definition of control that differs from that in SUBSIDIARIES, Section 1590, and might result in changing the entities that are required to be consolidated.

(b) IFRS Interpretation SIC-12, “Consolidation — Special Purpose Entities,” is not the same as ACCOUNTING GUIDELINE AcG-15, Consolidation of Variable Interest Entities.

(c) IAS 27 does not include guidance on investment companies that is comparable to ACCOUNTING GUIDELINE AcG-18, Investment Companies.

In deciding not to adopt IAS 27 in its entirety at this time, those requirements of Section 1600 that do not involve non-controlling interests will remain unchanged in
proposed new Section 1601. By separating the guidance for non-controlling interests from that for other aspects of consolidation, it will be easier to distinguish the guidance that is new from the guidance that is unchanged.\(^2\)

In addition, the following differences exist:

- Under Canadian GAAP, when the fiscal periods of a parent and a subsidiary are not coterminous, events relating to, or transactions of, the subsidiary that have occurred during the intervening period and significantly affect the financial position or results of operations of the group should be recorded or disclosed, as appropriate. Note that there is no specification of what is an acceptable gap; IAS 27 limits the discrepancy to no more than three months.

- IAS 27 requires that consolidated financial statements be prepared using uniform accounting policies for like transactions and other events in similar circumstances. Section 1601 does not contain specific guidance on whether uniform accounting policies should be used in the preparation of consolidated financial statements.

Articles in this series will discuss:

- IFRS 1 *First-time Adoption of IFRS*
- IFRS 3 *Business Combinations*
- IFRS 7 *Financial Instruments: Disclosures*
- IAS 1 *Presentation of Financial Statements*
- IAS 16 *Property, Plant and Equipment*
- IAS 27 *Consolidated and Separate Financial Statements*
- IAS 32 *Financial Instruments: Presentation*
- IAS 36 *Impairment of Assets*
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- IAS 38 *Intangible Assets*
- IAS 39 *Financial Instruments: Recognition and Measurement*

For a more comprehensive introduction to the adoption of IFRSs, see the online course *IFRS 3/IAS 27*, available on PD Net. You must be registered to access and purchase the course.

If you are not registered on PD Net, register now — it’s fast, easy, and free.

Brian and Laura Friedrich are the principals of friedrich & friedrich corporation, an accounting research, standards, and education firm. The firm provides policy, procedure, and governance guidance; develops courses, examinations, and other assessments; and supports the development of regional public accounting standards in Canada and internationally. Brian and Laura have served as authors, curriculum developers, lecturers, exam developers, and markers for numerous CGA and university courses in Canada, China, and the Caribbean. Their volunteer involvement has earned them CGA-BC’s inaugural Ambassador of Distinction Award (2004) and the J.M. Macbeth Award for service at the chapter level (Brian in 2006 and Laura in 2007). Brian and Laura are also Fellows of the Association of Chartered Certified Accountants (ACCA).

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