HA2032
Corporate Accounting

HOLMES INSTITUTE

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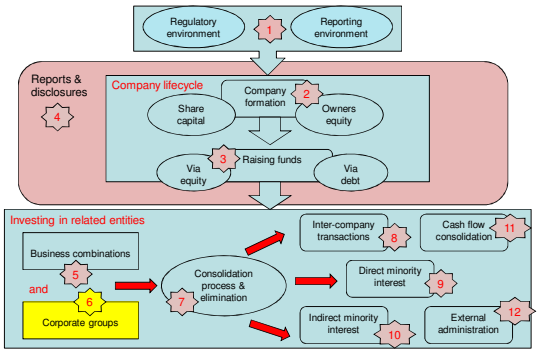
Topic 6
Corporate Groups and Consolidation

Studying Corporate Accounting



Underlying assumption

- Under AABS 127, the assumption concerning the nature and reporting of corporate group is: *the entity concept.*
- Its features and implication for financial reporting will be discussed later.

Regulation development

- A brief history:
  - AAS 24, released June 1990
  - AASB 1024, took effect from 31 December 1991
  - Amendments made to the *Corporations Law* in 1991 were to delete the group reporting method, other than consolidation and to discard *ownership* as the criterion for parent-subsidiary relationship.
  - The main law that is applicable now is the *Corporations Act 2001*
  - More compatible with accounting standards
  - AASB 127, replaced AASB 1024 in 2005
  - Compatible with the equivalent IAS 127.

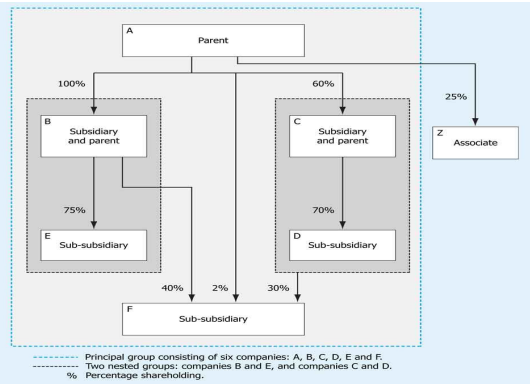
Components and role of the group

- The parent-subsidiary relationship:
  - The basic relationship exists in a group
  - A *corporate group* comprises the parent company and all its subsidiary companies (called 'consolidated entity' in the *Corporations Act*)
  - These entities are treated as a single *group* for financial reporting purposes
  - All entities in a group are related to each other, with *control* as the sole criterion that establishes such a relationship.

Components and role of the group contd

- Refer to figure 17.1 for a sample corporate group structure
- Table 17.2 displays parents interest in various subsidiaries

Components and role of the group contd



Components and role of the group contd

- Distribution of equity interests in the A company group between the ultimate parent and non-controlling interest

Table 17.2 Distribution of equity interests in the A company group between the ultimate parent and non-controlling interests

	Parent controlling interest		Non-controlling interests	
	Direct	Indirect	Direct	Indirect
Company A	100.0%			
Company B	100.0%			
Company C	60.0%		40.0%	
Company D		60% × 70% = 42.0%	30.0%	40% × 70% = 28.0%
Company E		100% × 75% = 75.0%	25.0%	
Company F	2.0%	100% × 40% + 60% × 70% × 30% = 40% + 12.6% = 52.6%	28.0%	30% × 30% + 40% × 70% × 30% = 9% + 8.4% = 17.4%

Components and role of the group contd

- Reasons for group formation:
  - Diversification
  - Integration
  - Pyramiding
  - Limited liability
  - Taxation.

The control criterion

- Control is the criterion to decide:
  - if a group has been formed
  - which entities belong within it.
- Definition of control:
  - 'The power to govern financial and operating policies of an entity so as to obtain benefits from its activities.' (AASB 127.4)
- Substance over form.

The control criterion

- The nature of control consists of three important elements:
  1 Power to govern
  - Having an ability or capacity to control
  - Minority shareholding, de facto control, potential power are sufficient.

  2 The areas under control
  - Both financial and operational policies.

  3 Benefits from activities
  - Must be provided by the subsidiary and enjoyed by the parent.

The control criterion

- Mechanisms of control:
  - Control of organs of power
    - To control an entity's governing body i.e. the board of directors
    - To control a company's general meeting.
  - Number of votes
    - Majority ownership of shares does not necessarily confer control
    - Yet, presumably majority ownership of voting shares confers control under a normal situation.

The control criterion

- Mechanisms of control:
  - Through operation of statute, contractual agreements, trust deed, etc.
- Joint and impaired control:
  - Do not constitute control ➔ does not give rise to parent-subsidiary relationship e.g. joint ventures.

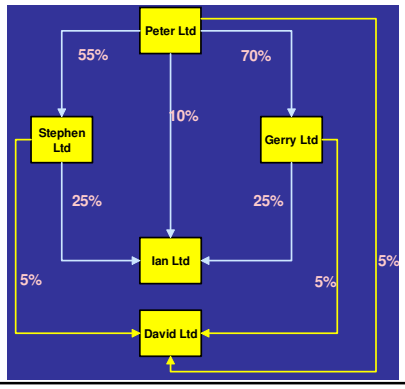
The control criterion

Example:

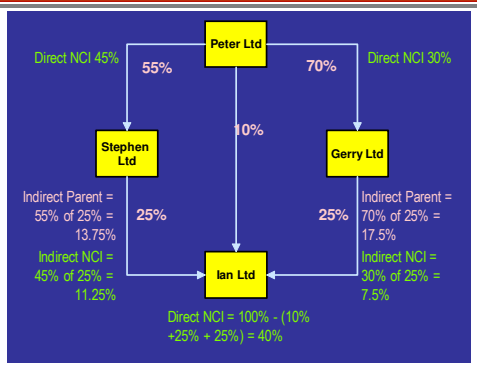
Peter Ltd owns 55% of the share capital of Stephen Ltd, 70% of the share capital of Gerry Ltd, 10% of the share capital of Ian Ltd, and 5% of the share capital of David Ltd. Stephen Ltd and Gerry Ltd both own 25% of the share capital of Ian Ltd and 5% of the share capital of David Ltd.

a) Prepare a diagram representing the group and identify the various minority interests, both direct and indirect
b) Determine which company (if any) has control of Ian Ltd under AASB 127
c) Determine which companies that would be included in the consolidated financial statements prepared by the parent company, Peter Ltd
d) Determine interest of parent and NCI in group members

The control criterion



The control criterion



The control criterion

Financial interests in Ian	Parent interest	NCI interest	
Direct	10.00%	40.00%	
Indirect via Stephen	13.75%	11.25%	
Indirect via Gerry	17.50%	7.50%	
Total	41.25%	58.75%	100%

Group reporting

- Argument for preparing consolidated financial statements:
  - information needs of users
  - report about parent company is inadequate.
- Group concepts and reporting objectives:
  - the entity concept has been adopted in Australian and international accounting standards.

The entity concept

- Features of the entity concept:
  - the group is a collection of entities under common economic control
  - it is a distinctive entity from its members
  - 'control' is the sole criterion defining the group and relationship between parent and subsidiary.

The entity concept (contd)

- Group reporting issues raised by adopting the entity concept include:
  - *The subject matter* of group reporting (consolidated financial statements) is the group itself, not the parent company
  - *Criteria for group recognition* (which entities belong to the group) rely on control as the sole basis
  - *The scope* of group financial statements is the collective performance and financial position of all group members.
  - Group reporting intended for a wide, diverse class of user

The entity concept (contd)

- Implications for reporting-related matters affected by the entity concept:
  - *entity status* of the group
  - group *boundary*
  - group *report status*
  - group *report content.*

Regulation of group reports

- The required consolidated statements include:
  - Balance sheet
  - Comprehensive profit statement
  - Cash flow statement
  - Changes in equity statement
  - Half-year interim financial report for disclosing entity
  - Comparative amounts for previous (corresponding) period
- Associated note disclosure in notes to financial statements

Disclosure

- Prescribed method:
  - In the form of a single set of consolidated financial statements
  - They must conform to AASBs 101, 107, 108 and 110
  - Additional disclosures about current period business combinations, and previous ones affected by current period events
- Disclosure:
  - In addition to the above, disclosures about remuneration of auditors and executives and directors.

Disclosure (contd)

- ASX listing rules:
  - Annual (audited) and half-year consolidated financial statements to be submitted within a maximum of 17 weeks and 75 days from the reporting date.