

Lesson 3: Consolidation

Refers to the **method** of combining and presenting the financial position and results of a parent company and its (several) subsidiaries in the combined (i.e., consolidated) financial statements of the parent company, as if they were a single entity (Group).

The method involves several steps including inter/intra-group charges and adjustments. In general, the financial statements of the group companies are added together with adjustments that are used to eliminate inter/intra-group indebtedness and trading.

CONSOLIDATED FINANCIAL STATEMENTS

N.B. In 2020, the International Accounting Standards board (IASB) issued some amendments ('Reference to the Conceptual Framework') related to IFRS 3 (first issued 2008), which deals with Business Combinations. Even if these amendments happen on occasion, the basics of the standard have remained relatively unchanged.

EQUITY METHOD

Accounting **method** for **associate companies** (or 'associated') in consolidated financial statements. Equity method is less than a consolidation but more than **carrying the investment at cost** and recording dividends received.

This accounting treatment applies when one company (= the investor) owns **20-50 % of the voting rights** in another company (= the investee).

- The investment initially measured at cost is adjusted subsequently for the post acquisition change in the investor's share of the net assets (E= A-L) of the investee:

<u>Investment (at cost):</u>	300,000
<u>Investee's net income for yr</u>	110,000
<u>Investor's share of the income (20%)</u>	22,000
<u>Investee pays a dividend</u>	50,000
<u>Investor's share of dividends (20%)</u>	-10,000*
<u>Investment (carrying value)</u>	312,000**

*If dividends were revenue, investor could boost its own income by demanding a higher dividend from investee

**Add these ending balances up and record the aggregate on consolidated IFRS balance sheet under 'Investments in Associates'

Line item:

INCOME FROM ASSOCIATES / SHARE OF THE RESULTS OF THE ASSOCIATED COMPANIES

Investee pays dividend -> investor recognizes the dividend payment as cash on the balance sheet, and reduces the investment (in the associate) by the same amount (i.e., the transactions cancel each other out)

COST METHOD

This accounting treatment applies when one company (= the investor) owns **less than 20 % of the voting rights** in another company (= the investee).

The investment is **carried at cost** and recording dividends received.

Measure at fair value

Measure at cost

Carrying amount / book value

Terminology, including the varied uses of the term ‘consolidation’:

To consolidate / consolidation

To **consolidate** the different classes of shares – i.e., to **combine**...

Company X continues to **consolidate** its market position – i.e., to **strengthen**...

The prolonged recession led to closures and **facility consolidations** – i.e., the facilities were **reorganized and combined**

The **ongoing consolidation** of the tech sector – i.e., the sector companies **combined** their operations

Consolidated sales = group sales

It is not necessary to include a subsidiary in the **consolidated financial statements** if the ownership by the parent is short-term and with the view of subsequent resale and disposal.

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