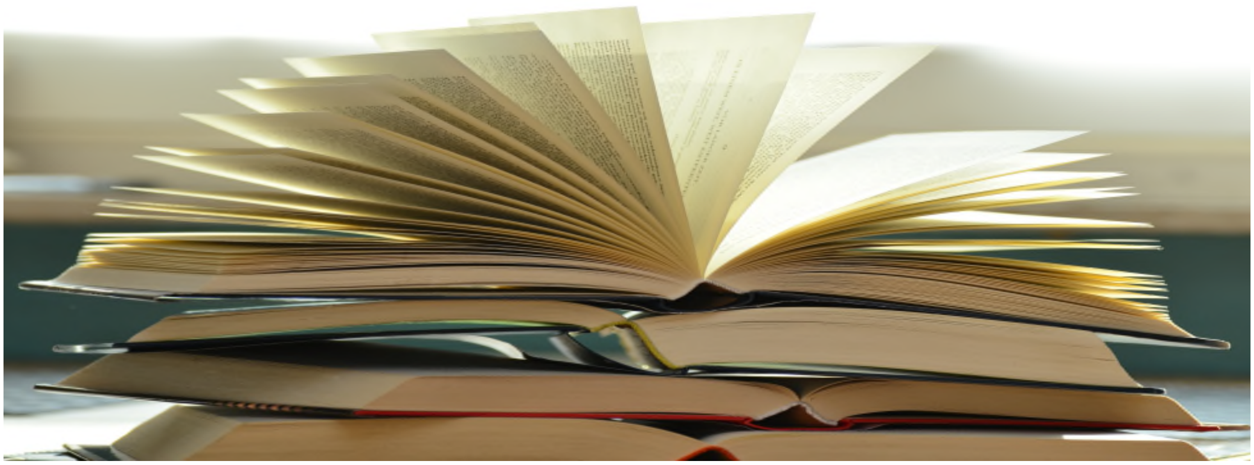

ASPE 1601 Consolidated Financial Statements and ASPE 1602 Non-Controlling Interests

Implementation Guide

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Introduction to Consolidation

Consolidation commonly arises from a business combination involving acquisition of shares. In such a transaction, the parent (acquirer) and the subsidiary (acquiree) remain two separate legal entities; however, they have joined together economically to essentially form a single economic entity. To properly present the operation of the resulting economic entity, consolidated financial statements are prepared.

Note! Consolidated Financial Statements refer to those financial statements that combine, on a line-by-line basis, one or more subsidiaries with the parent company. Its preparation requires elimination of intercompany balances and transactions, and presentation of any non-controlling interest in the subsidiaries.

This guide discusses the accounting requirements of ASPE 1601 *Consolidated Financial Statements* with respect to the preparation of consolidated financial statements. When preparing its first consolidated financial statements, an entity would follow the initial measurement and recognition rules as described in ASPE 1582 *Business Combinations*. For detailed guidance on how to record a business combination transaction at the date of acquisition, please refer to MNP ASPE 1582 *Business Combinations* Guide. The principles of this guide should still be used as general guidance for any combinations involving unincorporated business or any other situations that involves a combination or consolidation of entities other than through purchase of an equity interest.

Consolidated financial statements may either be prepared when the parent owns 100% of the subsidiary(ies) or less than 100% of the subsidiary(ies), but the parent still controls the subsidiary(ies). ASPE 1591 *Subsidiaries* provides an accounting policy choice either to consolidate subsidiaries or account for subsidiaries using cost or equity method. For detailed guidance on the accounting methods, please refer to MNP ASPE 1591 *Subsidiaries* Guide. If less than 100% interest is acquired, the parent will need to account for the non-controlling interests exist in the subsidiaries. *Non-controlling interest* ("NCI") is defined as the equity in a subsidiary not attributable, directly or indirectly, to a parent. In other words, interest owned in the subsidiary other than by the parent. This guide also provides guidance for the accounting for an NCI in consolidated financial statements where the parent acquires less than 100% ownership interest in accordance with ASPE 1602 *Non-controlling Interests.*

ASPE 1601 and ASPE 1602 apply to annual financial statements relating to fiscal years beginning on or after January 1, 2016, with early application permitted.

Consolidated financial statements do not reflect the activities of a real legal entity and for this reason, it is essential that users have a clear understanding of the limitations and the usefulness of such statements for the intended purposes. In general, consolidated financial statements are prepared for the needs of the parent's shareholders. For this reason, other parties that have an interest in one or more of the combining companies (e.g., NCI, creditors, tax authorities, etc.)

will most likely not find these statements overly beneficial.

Note! Combined Financial Statements vs. Consolidated Financial Statements

This guide does not specifically cover combined financial statements; however, similar principles would be used when preparing such statements. Combined financial statements refer to the presentation of financial results of affiliated companies on a group basis that do not include the parent company. While they cannot substitute consolidated financial statements, such statements may be useful in certain circumstances such as:

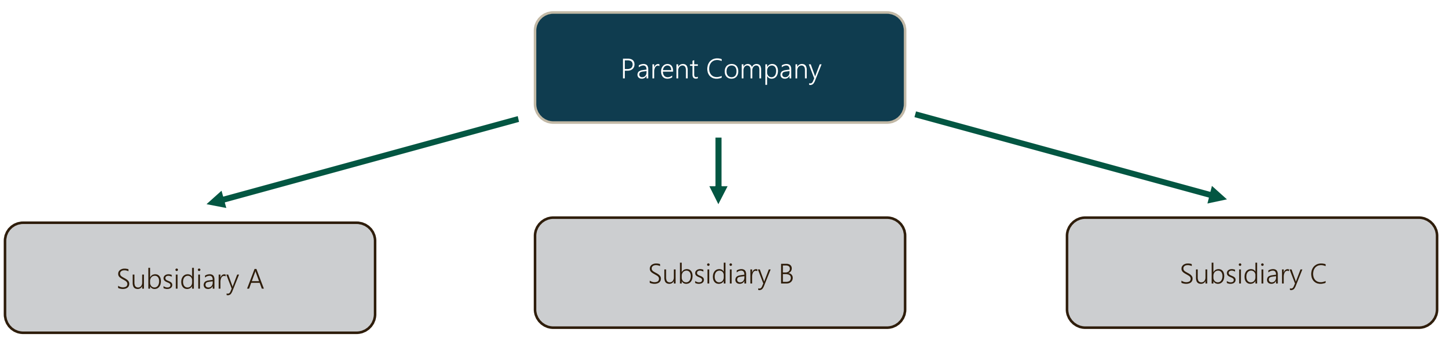
- If one individual owns a controlling interest in several corporations;
- To present a financial position and the results of operations of a group of subsidiaries; or
- To combine the financial statements of companies under common control.

Multiple Investments

Consolidation may include multiple investment holdings. There are three general types of situations that can cause consolidation of more than one investment holding.

Multi-company Affiliation

In this situation, a single parent company acquires, by direct investment, two or more subsidiaries. This type of situation does not add complications and requires the parent to basically treat each subsidiary as if it were the only investee and then combine all the financial data.



Multi-level Affiliation

This situation is different in that there is an indirect ownership by the parent. Control is obtained through owning voting shares of an entity, who also owns a controlling interest in another entity. Note that the ownerships have to be in one direction (i.e., there are no reciprocal shareholdings).

Reciprocal Shareholdings

This situation is distinguished from the above in that there are both upstream and downstream investments. Therefore, the parent owns interest in the subsidiary and the subsidiary owns interest in the parent. This situation adds considerable complexity to the consolidation process because the parent will need to determine the subsidiary's share in its retained earnings to be able to determine its share of the subsidiary's retained earnings. Given the correlation between the two, simultaneous equations are necessary to figure out the calculations.

For additional guidance, please refer to *Additional Aspects of Consolidation - Reciprocal Shareholdings* section of this guide.

Consolidation at Acquisition

At Acquisition

Step 1 – Elimination of 100% of the Investment in the Subsidiary Account

Step 2 – Elimination of 100% of all Acquisition-date Balances in the Subsidiary's Shareholders' Equity (including share capital and retained earnings/deficit)

Step 3 – Allocation of Differential to 100% of Fair Value Changes on Identifiable Assets and Liabilities and Goodwill (or a Bargain Purchase Gain)

Step 4 – Recognition of Non-controlling Interest, if Applicable (i.e., When Less than 100% Ownership)

Step 5 – Elimination of 100% of Intercompany Assets and Liabilities

When consolidated financial statements are prepared, the investment in the subsidiary(ies) will be replaced by:

- The identifiable assets and liabilities of the subsidiary(ies);
- The non-controlling interest, if applicable; and
- The goodwill resulting from the business combination.

Any assets, liabilities and goodwill acquired as part of the business combination would be recognized using the acquisition method. A simplistic view of the acquisition method would be that the assets, liabilities and goodwill acquired would be recorded at their respective fair values at the acquisition date. For detailed discussion on this method, please refer to MNP ASPE 1582 *Business Combination* Guide.

In simplified terms, the preparation of the consolidated balance sheet at acquisition involves adding together corresponding assets, labilities and equities of the parent and the subsidiary(ies). However, some additional adjustments may be required when consolidating as discussed later, so that the consolidated financial statements in essence presenting a single economic entity.

Note! The consolidation of a subsidiary starts at the date the parent acquires control and will continue as long as control exists. A parent would not retroactively consolidate a subsidiary for periods prior to the acquisition of control.

Note!

- A consolidation working paper would be maintained that would record the consolidation process and adjustments required for consolidation. Consolidation adjusting entries would not be recorded in the single entity records of either the parent or subsidiaries, unless push-down accounting is applied in accordance with ASPE 1625 *Comprehensive Revaluation of Assets and Liabilities*.
- The carrying values reported by the subsidiary(ies) are most likely inconsistent with the new carrying values of the consolidated entity. At the time of acquisition, the treatment is fairly simple; however, as discussed later in this guide, in subsequent years we would have to consider the amortization of such fair value changes, unless push-down accounting has been used.

Step 1 – Elimination of 100% of the Investment in the Subsidiary Account

The parent typically shows an investment in its set of books, representing its ownership of the net identifiable assets of the subsidiary(ies). Upon consolidation, the actual assets and liabilities of the subsidiary(ies) will be picked up; therefore, the investment account would need to be eliminated for it not to be double counted in the consolidated financial statements. A consolidation adjustment will need to be prepared to eliminate 100% of the investment in the subsidiary(ies), regardless of the presence of a NCI, as illustrated in Example 1 of this guide.

Note! The single entity financial statement of the parent can account for the subsidiary(ies) subsequent to acquisition at cost or equity method. Depending on the accounting method chosen, the consolidation entry will be different. However, this is a matter of bookkeeping since the same consolidation principles would apply regardless of the accounting method. For the examples presented in this guide, we assume the cost method is used.

Step 2 – Elimination of 100% of all Acquisition-date Balances in the Subsidiary's Shareholders' Equity

Share Capital and Contributed Capital

From the perspective of the consolidated entity, when the parent owns 100% of the subsidiary(ies), the subsidiary(ies) would not have shares outstanding (i.e., no party external to the consolidated entity holds any common shares of the subsidiary(ies)). Therefore, elimination of the subsidiary's share capital and contributed capital would be required, as illustrated in Example 1 of this guide.

If the parent owns less than 100% of the subsidiary(ies), the equity interest owned by external shareholders in the subsidiary(ies) would be included in the consolidated balance sheet. This interest would not be presented as shares outstanding or retained earnings, but would rather be presented as the equity of the NCI in the consolidated net assets.

Consolidated Retained Earnings

Retained earnings represents the accumulation of undistributed earnings of a company. The parent has only acquired ownership of the subsidiary(ies) at the date of acquisition, and therefore only earnings generated by the subsidiary(ies) subsequent to acquisition should be included as part of the consolidated entity. For this reason, it would not be appropriate to include the subsidiary(ies)'s retained earnings nor deficit that existed at the time of acquisition in the consolidated retained earnings.

In addition, the retained earnings or deficit of the subsidiary(ies) and/or the parent may contain gains or losses that arose from transactions between the parent and the subsidiary(ies) before the date of acquisition. It should be noted, the intercompany transactions that occurred before the date of acquisition would not be eliminated as these transactions are considered to be at arm's length, unless the transactions were made in contemplation of the acquisition (i.e., part of the business combination transaction). The later section(s) of this guide discuss the elimination of intercompany transactions.

Example 1 – Elimination of Investment Account and Subsidiary's Equity at Acquisition Date

Company A acquired 100% of Company B on January 1, 2021 for $3,300,000. All of the acquired assets and labilities have fair values equal their carrying values and the purchase price is equal to the net assets of Company B.

The following information represents Company B's equity balance at the time of acquisition.

Subsidiary Equity Information

No par common shares	2,000,000
Retained earnings	1,300,000

Assessment: As part of the consolidation process, Company B's retained earnings and outstanding shares need to be eliminated. In addition, an adjustment has to be made to eliminate Company A's investment in Company B.

The following entry would be prepared:

No par common shares (Company B)	2,000,000	
Retained earnings (Company B)	1,300,000	
Investment in Company B (Company A)		3,300,000

Step 3 – Allocation of Differential to 100% of Fair Value Changes and Goodwill (or a Bargain Purchase Gain)

When eliminating the subsidiary(ies)'s equity against the parent's investment in the subsidiary, a differential may be created (i.e., the cost of the parent's investment is different than the parent's share of the book value of the shareholders' equity of the subsidiary(ies) acquired). This can happen when the fair values of the acquired assets and liabilities do not equal their carrying values at the acquisition date. A differential can also be created when goodwill is acquired as part of the business combination or when the business is acquired through a bargain purchase.

The differential will form part of the elimination entry. First it should be noted, this differential will not disappear because it is needed to balance the elimination of the investment account and the shareholders' equity of the subsidiary(ies). In addition, it cannot simply be included in the consolidated balance sheet with the account title differential or purchase price discrepancy. This differential will have to be allocated among a group of debits and credits to the following three types of balances (and these items will replace the differential amount in the elimination entry):

Fair value changes on identifiable assets and liabilities	100% of fair value changes will be recorded to the related asset and liability accounts (i.e., the carrying values of those assets and liabilities would be adjusted by the amount of fair value changes on the combined entity's books). The required adjustments are illustrated in the "Adjustments for Fair Value Changes" table below.
Goodwill	Goodwill is measured at the time of the business combination and represents the future economic benefits that will be derived from other assets acquired during the business combination. The amount recorded will depend on the NCI measurement.
Gain on bargain purchase	Gain on a bargain purchase is recognized in net income at the time of the business combination when the purchase price is less than the fair value of the acquired identifiable assets.

If the fair values of the assets and liabilities acquired agree to the carrying values and no goodwill has been acquired, or the business was not acquired through a bargain purchase, there would be no differential.

The carrying values are adjusted as follows for fair value changes:

	Fair Value Increase	Fair Value Decrease
Assets	Added (record as debits)	Subtracted (record as credit)
Liabilities	Subtracted (record as credits)	Added (record as debits)

Example 2 –Allocation of Differential

This example uses the facts from Example 1 above, except for the transaction resulted in a differential upon elimination of the parent's investment and the subsidiary's shareholders' equity.

Company A acquired 100% of Company B on January 1, 2021 for $3,300,000. Majority of acquired assets and labilities have fair values equal their carrying values, except for property, plant and equipment and inventory. No goodwill or bargain purchase gain was created as part of this transaction.

	Carrying Value	Fair Value	Difference
Property, plant and equipment	600,000	1,150,000	550,000
Inventory	250,000	200,000	(50,000)

The following information represents Company B's equity balance at the time of acquisition.

Subsidiary Equity Information	
No par common shares	2,000,000
Retained earnings	800,000

Assessment: The elimination entry would be consistent with the entry made in Example 1. However, in this scenario a differential would be created, as not all net assets had carrying values equal to their fair values at the date of acquisition.

Given that the transaction has not resulted in any goodwill nor bargain purchase gain, the entire differential is due to the fair value changes (i.e., the overall difference in carrying values to the fair values of property, plant and equipment and inventory of $500,000 ($550,000 - $50,000)). Accordingly, the differential is allocated to the accounts of property, plant and equipment and inventory, to reflect the fair value adjustments, as part of the elimination entry presented below.

The following entry would be prepared:

No par common shares (Company B)	2,000,000	
Retained earnings (Company B)	800,000	
Property, plant and equipment	550,000	
Inventory		50,000
Investment in Company B (Company A)		3,300,000

Step 4 – Recognition of Non-controlling Interest (“NCI”)

Consolidated financial statements are prepared even if the parent owns less than 100% ownership interest in a subsidiary but has control over the subsidiary. The diagram below summarizes the consolidation approaches under each situation:

100% Ownership	Less than 100% Ownership
• 100% of the subsidiary is consolidated. • NCI does not exist and is not presented. • There is only one way of presenting the consolidated financial statements.	• 100% of the subsidiary is consolidated. • NCI exists and is presented. • There are two ways of of measuring NCI as per ASPE 1582, which creates two presentation alternatives for the consolidated statements: • ***Proportionate Share of Fair Value*** – interest is based on the fair value of the identifiable net assets. NCI's share of goodwill is not recognized. • ***Direct Measurement of Fair Value*** – NCI is based on the fair value of the enterprise acquired. NCI's share of goodwill is recognized.

The NCI has an interest in both the net assets and the net income of the subsidiary. The interest held by the NCI in the subsidiary can be both voting shares as well as any other classes of shares (e.g., preferred shares) not owned by the parent. If the parent owns less than 100% of the subsidiary(ies), the consolidated entity has to identify the NCIs in the following areas:

NCIs in the net income of the consolidated subsidiary(ies) for the reporting period

At the date of acquisition, there would be no income to consolidate from the subsidiary(ies). The parent would have no right to earnings from periods prior to the acquisition. For this reason, there would be no NCI on the income statement to report at the date of acquisition. However, immediately after acquisition, once the parent has a right to the subsidiary(ies)’s net income, the consolidated financial statements will have to take into consideration the NCI present in the subsidiary(ies)’s net income.

Accordingly, the consolidated net income, for periods subsequent to the acquisition, is made up of both the parent’s and the subsidiary(ies)’s income. When an NCI is present, such interest will be deducted to arrive at the controlling interest in the consolidated net income.

Note! The NCI reflected in the consolidated income statement is not a deduction to arrive at net income, but rather the identification of the NCI portion within the net income of the consolidated subsidiary(ies) for the reporting period. Net income will be attributed to the NCI even if it causes a deficit balance.

NCIs in the net assets of the consolidated subsidiary(ies)

NCIs in the net assets of the consolidated subsidiary(ies) is identified separately from the interest owned by the parent, which consist of:

- The NCIs recognized at the date of the original combination in accordance with ASPE 1582; and
- The NCIs' share of change in equity since the date of the original combination.

While presented as an aggregate figure on the consolidated balance sheet, the NCI can be very diverse in content. It could reflect an equity in several different classes of shares (e.g., non-voting or preferred shares). Adding to its complexity would be situations where the parent has fractional ownership on multiple subsidiaries such that the NCI reported would consist of interests held by various non-controlling groups in each of the consolidated subsidiaries. Regardless of its composition, the NCI would be presented as a single line item within equity, separately from the parent's equity, in the consolidated balance sheet.

Note! Some preferred shares, in accordance with ASPE 3856 *Financial Instruments*, may be required to be classified as a liability. These preferred shares are not included in the NCI.

Note! When potential voting rights exist, the allocation of net income and changes in equity to the parent and NCIs are based on the present ownership interest and not on the possible exercise or conversion of such potential voting rights.

If a consolidated subsidiary is a self-sustaining foreign operation, the portion of exchange gains and losses arising from the translation of the subsidiary's financial statements relating to the NCI should be allocated to the NCI's equity, which is presented as a separate component of equity of the combined entity; rather than including the amounts with the exchange gains or losses of the controlling interest, which is also presented as a separate component of equity.

Example 3 – Consolidation at the Acquisition Date with Fractional Ownership

Company A acquired 90% of Company B on January 1, 20XX for $3,000,000. Company B's identifiable net assets have fair values equal to their carrying values at the date of acquisition, except for the following items:

	Carrying Value	Fair Value	Difference
Property, plant and equipment	600,000	800,000	200,000
Inventory	300,000	200,000	(100,000)

There were no intercompany transactions between the two entities prior to the business combination.

<u>Other Information Gathered</u>

Company A information at the time of acquisition	
Property, plant and equipment	1,000,000
Inventory	500,000
Company B information at the time of acquisition	
Total carrying value of Company B's net assets	2,800,000
No par common shares	800,000
Retained earnings	2,000,000

Assessment: Given that Company A does not own 100% of Company B, Company A will have to determine the NCI at the acquisition date, in addition to the fair value changes and goodwill, in order to allocate the differential.

Carrying value of identifiable net assets	2,800,000
Increase in fair value of property, plant and equipment	200,000
Decrease in fair value of inventory	(100,000)
Fair value of Company B's identifiable net assets	2,900,000

Example 3 – Consolidation at the Acquisition Date with Fractional Ownership *(Continued from previous page)*

As discussed, two methods are available to calculate NCI. In this example, NCI has been calculated using the direct measurement of fair value method (based on fair value of the entity acquired).

Investment cost (consideration transferred)	3,000,000
Non-controlling interest (10% × (3,000,000 ÷ 90%))	333,333
Subtotal	3,333,333
Fair value of Company B's identifiable net assets	(2,900,000)
Goodwill	433,333

Company A will prepare the following consolidation entry by replacing the differential with the calculated fair value changes, goodwill and NCI.

No par common shares (Company B)	800,000	
Retained earnings (Company B)	2,000,000	
Goodwill	433,333	
Property, plant and equipment, net	200,000	
Inventory		100,000
Non-controlling interest		333,333
Investment in Company B (Company A)		3,000,000

Step 5 – Elimination of 100% of Intercompany Assets and Liabilities

It is not uncommon for the parent and the subsidiary(ies) consolidated companies to have some sort of business interaction before the business combination and such transactions may result in receivables or payables from one another outstanding at the date of acquisition. Given the purpose of the consolidated financial statements is to present two or more separate legal entities as a single economic unit, these intercompany balances must be eliminated upon consolidation.

Consolidation Subsequent to Acquisition

Post-acquisition

Step 6 – Realization of Post-acquisition Fair Value Changes

Step 7 – Recognition of Current and Cumulative Goodwill Impairment Losses

Step 8 – Elimination of 100% of Intercompany Expenses and Revenues

Step 9 – Elimination of Intercompany Dividends

Step 10 – Elimination of Unrealized Intercompany Profits (Losses) – 3 Scenarios

Post-acquisition consolidated financial statements are based on the amounts assigned to assets, liabilities and NCI at the date of acquisition, and adjusted for any effects of transactions subsequent to that date.

The preparation becomes much more complex at this stage. There will be new items that need to be dealt with on the consolidated balance sheet, such as fair value changes amortization, goodwill impairment losses, unrealized intercompany profits (losses), and the allocation of the subsidiary(ies)'s retained earnings since acquisition. Subsequent to acquisition, the enterprise will also have to compute the consolidated net income and prepare the consolidated income statement and consolidated statement of retained earnings.

The five steps that were performed during the preparation of consolidated financial statements at the date of acquisition will have to be reperformed for consolidation subsequent to acquisition.

Step 6 – Realization of Post-acquisition Fair Value Changes

As discussed earlier, at the date of acquisition the consolidated financial statements record any acquired assets, liabilities and goodwill as per the acquisition method. Therefore, the consolidated financial statements include fair value changes on the subsidiary(ies)'s assets and liabilities at the time of acquisition. Unless push-down accounting is applied, the subsidiary(ies)'s books would not reflect these fair value changes. In this situation, an adjustment will have to be made each time consolidated financial statements are prepared for the fair value changes to be included.

When the fair value changes relate to assets and liabilities that are depreciable or measured at amortized cost, it gives rise to additional issue in post-acquisition periods in terms of depreciation and amortization of such changes. Without applying push-down accounting, the subsidiary(ies)'s depreciation and amortization will be based on their carrying values and not the acquisition-date fair values that have been included in the consolidated financial statements. For this reason, additional consolidation adjustments will have to be made to account for the difference in amortization charges.

Note! Depreciation, depletion and amortization of the assets of a consolidated subsidiary(ies) are based on the amounts determined at the date of acquisition by the parent.

There are essentially three types of fair value changes that are subject to different subsequent accounting treatments:

Types of Fair Value Changes	Treatment Subsequent to Acquisition		Sale/Disposal
	Balance Sheet	Income Statement	
Fair value changes on current assets (e.g., inventory)	*Amortization of fair value changes is not required.*		Fair value change will be fully realized when asset is sold, usually within a year of acquisition. Profit (loss) on sale will reflect the realization of the fair value change (e.g., when inventory is sold, cost of goods sold would be adjusted by the fair value change).
	If asset remains unsold at period-end, its carrying value on the consolidated balance sheet would reflect the fair value change (i.e., greater or smaller by the fair value change than what is recorded on the Subsidiary's records (Step 3)).	No impact on income statement until asset is sold.	
Fair value changes on assets with unlimited lives (e.g., land)	*Amortization of fair value changes is not required.*		Fair value change will be fully realized when asset is sold/disposed. Gain (loss) on disposal will reflect the realization of the fair value change.
	If asset is still owned by the consolidated entity at period-end, its carrying value on the consolidated balance sheet would reflect the fair value change (i.e., greater or smaller by the fair value change than what is recorded on the Subsidiary's records (Step 3)).	No impact on income statement until asset is sold.	

<table>
<tr>
<td rowspan="2">Fair value changes on long-term assets and liabilities with limited lives (e.g., property, plant and equipment)</td>
<td colspan="2">Amortization of fair value changes is realized through the use of the asset.</td>
<td rowspan="2">The unamortized fair value change will be fully realized when the asset is sold/disposed, or liability is eliminated, prior to the end of its life/term. Gain (loss) on disposal will reflect the realization of the remaining fair value change.</td>
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<tr>
<td>The carrying value of the asset or liability would reflect the unamortized fair value change at each period-end (i.e., greater or smaller by the remaining fair value change than what is recorded on the Subsidiary's financial statements (Step 3)).

Opening consolidated retained earnings would require adjustment for any fair value change realized in prior periods.</td>
<td>Each year the expense associated with the asset or liability will be adjusted to reflect the amortization of the fair value change over the life/term of the asset or liability (e.g., amortization for depreciable assets, or interest expense on financial liabilities, would be adjusted by the amortization of the fair value change).</td>
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Example 4 – Realization of Post-acquisition Fair Value Changes

Company A acquired 100% of Company B's outstanding shares. For the purpose of this example, we will only look at one building that is part of Company B's net assets. The building's fair value at the date of acquisition was $600,000 and the carrying value recorded by Company B was $500,000. Per Company B's records, the building has a remaining useful life of 15 years at the time of acquisition and is amortized using the straight-line method. This is consistent with the useful life assessment made at the date of acquisition.

Assessment: Subsequent to the acquisition, both the combined entity and Company B will apply straight line amortization over 15 years for this building. However, the balance to be amortized will differ for the purposes of the consolidated financial statements and Company B's single entity statements. In particular, Company B will amortize $500,000 (i.e., carrying value at the date of acquisition), while the combined entity will amortize $600,000 (i.e., fair value at the date of acquisition).

Therefore, when Company B's numbers are consolidated, the combined entity will only pick up amortization expense for this building of $33,333 ($500,000 ÷ 15) recorded by Company B. To reflect the appropriate amortization expense based on the acquisition-date fair value for the combined entity of $40,000 ($600,000 ÷ 15), an annual adjustment of $6,667 will be required in the consolidated financial statements for the next 15 years.

Example 4 – Realization of Post-acquisition Fair Value Changes ***(Continued from previous page)***

The required journal entries for the first three years are as follows:

Year 1

Amortization expense	6,667	
Building, net		6,667

Year 2

Retained earnings, opening (Company B)	6,667	
Amortization expense	6,667	
Building, net		13,334

Year 3

Retained earnings, opening (Company B)	13,334	
Amortization expense	6,667	
Building, net		20,001

The entry to adjust amortization would have to be done each year until the building is fully amortized. The combined entity would have amortized an additional $100,000 over the remaining life of the building (15 years), compared to the amortization recorded by Company B. Note, even after the asset is fully amortized, an entry will have to be made to reduce Company B's opening retained earnings by the $100,000 fair value change. The purpose of this adjustment is to account for that additional $100,000 of amortization made, which intends to offset the fair value change recognized initially at acquisition (Step 2) and brings the net book value of the building to zero on the consolidated balance sheet.

Entry after Building is Fully Amortized

Retained earnings, opening (Company B)	100,000	
Building, net		100,000

Step 7 – Recognition of Goodwill Impairment

The first thing to remember with goodwill acquired through a share purchase acquisition is that the subsidiary(ies) would not have recorded the goodwill on its books, unless push-down accounting is applied. Therefore, the goodwill only exists on the books of the consolidated entity typically (as part of the consolidation adjustment under Step 2).

In accordance with ASPE 3064 *Goodwill and Intangible Assets*, goodwill is carried at the amount initially recognized, less any write-down for impairment. It is further required that goodwill be tested for impairment when events or changes in circumstances indicate that the carrying amount of the reporting unit to which the goodwill is assigned may exceed the fair value of the reporting unit. Refer to MNP ASPE 3064 *Goodwill and Intangible Assets* Guide for further guidance on goodwill impairment assessment.

In the period the impairment occurred, an adjustment would be made to reduce goodwill and an impairment loss would be charged to consolidated net income. Like other types of fair value write-offs, the goodwill impairment loss is only recorded in the consolidated financial statements and will not be recorded in the subsidiary(ies)'s books.

In subsequent years, a debt adjustment would be made to reduce opening retained earnings for the cumulative goodwill impairment losses of previous years, and a corresponding credit adjustment to the carrying value of goodwill on the consolidated financial statements.

Step 8 – Elimination of 100% of Intercompany Balances and Transactions

As discussed earlier, all intercompany balances should be eliminated. At the date of acquisition, intercompany accounts would be limited to assets and liabilities. However, subsequent to acquisition these accounts can include assets, liabilities, revenues and expenses, arising from post-acquisition transactions between the parent and the subsidiary(ies) such as intercompany purchases and sales, or intercompany financing. Regardless of their nature, intercompany accounts would still be eliminated

Elimination of Intercompany Assets and Liabilities Subsequent to Acquisition

Intercompany assets and liabilities will have to continue to be eliminated subsequent to the acquisition date. As the combined entity starts to operate as one economic entity, the parent and the subsidiary(ies) may undertake intercompany transactions that create more intercompany assets and liabilities. For this reason, any loans, receivables, payables, etc. from the subsidiary(ies) to the parent, or vice versa, arising subsequent to acquisition, would be eliminated in the consolidated financial statements in the same manner as they were at the date of acquisition.

Example 5 – Elimination of Intercompany Balances Subsequent to Acquisition Date

Company A acquired 100% of Company B on January 1, 20XX. Company A is in the process of preparing its consolidated financial statements for the year ended December 31, 20XX. At year-end, Companies A and B show the following balances on their balance sheets:

Company A

Accounts receivable	300,000	(includes $50,000 receivable from Company B)
Note receivable	500,000	(due from Company B)
Accounts payable	150,000	(includes $20,000 due to Company B)

Company B

Accounts receivable	450,000	(includes $20,000 receivable from Company A)
Accounts payable	200,000	(includes $50,000 due to Company A)
Note payable	500,000	(due to Company A)

Assessment: There are several intercompany balances present at December 31, 20XX. A summary is as follows:

Company A

Accounts receivable from Company B	50,000
Note receivable from Company B	500,000
Accounts payable to Company B	20,000

Company B

Accounts receivable from Company A	20,000
Accounts payable to Company A	50,000
Note payable to Company A	500,000

Example 5 – Elimination of Intercompany Balances Subsequent to Acquisition Date *(Continued from previous page)*

For the purposes of consolidated financial statements where Companies A and B are viewed as one single economic entity, the intercompany balances have no real economic existence and therefore should be eliminated upon consolidation. Ignoring any potential revenue, expenses and profits or losses associated with these balances, the following entries will have to be made for consolidation purposes:

Elimination of Accounts Receivable of Company A and Accounts Payable of Company B:

Accounts payable (Company B)	50,000	
Accounts receivable (Company A)		50,000

Elimination of Accounts Receivable of Company B and Accounts Payable of Company A:

Accounts payable (Company A)	20,000	
Accounts receivable (Company B)		20,000

Elimination of Note Receivable of Company A and Note Payable of Company B:

Note payable (Company B)	500,000	
Note receivable (Company A)		500,000

In practice, the associated revenue, expenses and unrealized profits or losses, if any, will also require elimination on consolidation.

Elimination of Intercompany Expenses and Revenues Subsequent to Acquisition

Intercompany expenses and revenues often get removed as part of the unrealized intercompany profits (losses) elimination. However, when the asset(s) transferred in an intercompany transaction (e.g., all the merchandise relating to an intercompany purchase/sale) is sold at period-end, there would be no unrealized profits (losses) to eliminate. In these situations, the intercompany revenue and expense relating to this transaction would still require elimination in order to not overstate consolidated sales and expenses. In addition, sometimes, intercompany revenues and expenses may not have an impact on the combined net income. For example, if the subsidiary pays interest on a loan due to the parent company, the parent company will record interest revenue equal to the interest expense recorded by the subsidiary. Therefore, upon consolidation there would be no impact on the combined net income, but both revenues and expenses would be overstated and elimination would still be required.

The principal to eliminate these transactions is identical to those involved in eliminating intercompany assets and liabilities. When the parent and its subsidiary(ies) are viewed as a single accounting entity, the intercompany expenses and revenues are considered transactions with no real economic existence and therefore should be eliminated.

It should be noted, regardless of the parent's ownership in the subsidiary(ies), 100% of intercompany revenues and expenses are removed. Such elimination aims to avoid overstatement of revenues and expenses and has no impact on the determination of consolidated net income, unless the eliminated items contain unrealized intercompany profits (losses). As a result, the elimination does not affect either the non-controlling or controlling share of net income.

The required adjustment would be a simple debit to the revenue account of the selling/receiving company and a credit to the corresponding expense account of the purchasing/disbursing company for the transaction amount.

Example 6 – Elimination of Intercompany Revenue and Expenses

Company A (parent) has a note receivable from Company B (subsidiary). Company A earns $1,000 a year in interest on this note receivable.

Assessment: In this situation, Company A would record $1,000 of interest revenue and Company B would record $1,000 of interest expense in their single entity statements. When the two sets of books are consolidated, the consolidated financial statements would show $1,000 in interest revenue and $1,000 in interest expense. As all intercompany transactions should be eliminated on consolidation, the following entry would be required:

Interest revenue (Company A)	1,000	
Interest expense (Company B)		1,000

Note that the adjustment will have a $nil impact ($1,000 of revenue - $1,000 of expense) on the combined income.

Step 9 – Elimination of Intercompany Dividends

Another common intercompany transaction is intercompany dividends, where dividends are declared and paid by the subsidiary(ies) to the parent. While intercompany dividends should be eliminated for the same reason as intercompany expenses and revenues, the required elimination procedures are very different. This is due to the fact that dividend payments are not included in the determination of net income.

Dividends paid to NCI are considered an actual distribution of the consolidated entity's resources. Therefore, this distribution needs to be accounted for in the consolidated financial statements (i.e., does not require elimination on consolidation). The dividend declared to NCI would be charged directly to the NCI account on the consolidated balance sheet. Further, these dividends will be shown separately on the consolidated cash flow statement. The elimination entry will depend on the presentation of NCI in income as discussed below.

ASPE 3251 *Equity* requires the statement of change in equity to include:

(a) Presentation of net income (loss) attributable to the parent and NCI separately
(b) Presentation of any dividends declared – it depends on how the NCI in income is presented under (a).

Note! No adjustments will be required in subsequent periods for dividends paid. The parent's portion of the declared dividend will be included in its retained earnings in subsequent periods and therefore will become a part of the consolidated retained earnings. This is appropriate since the resources still remain with the consolidated entity.

Example 7 – Elimination of Intercompany Dividends

Company B declared and paid dividends of $100,000. Company B is controlled by Company A who owns 75% of Company B's outstanding shares. Company A recorded $75,000 in dividend revenue.

Assessment: As discussed, the elimination procedure for intercompany dividends depends on the presentation of NCI in income on its consolidated statement of change in equity. For the purpose of this example, it is assumed that the consolidated entity will subtract the NCI in income before deducting the dividends; therefore, the dividends amount will exclude the portion paid to non-controlling shareholders. Based on such presentation, the consolidated entity should eliminate 100% of Company B dividends, including the amounts paid to Company A and non-controlling shareholder.

Example 7 – Elimination of Intercompany Dividends *(Continued from previous page)*		
The following entry will be prepared in the consolidated financial statements:		
Dividend revenue (Company A)	75,000	
Non-controlling interest (balance sheet)	25,000	
Dividends declared (Company B)		100,000
As the dividend declared to the non-controlling shareholders is directly applied to the NCI account on balance sheet, separate disclosure of the $25,000 must be made in the consolidated cash flow statement.		

Step 10 – Elimination of Unrealized Intercompany Profits (Losses)

Profits (losses) resulting from intercompany transactions are not considered to have been realized until they are verified by an arm's length transaction with an individual or entity that is not part of the consolidated group. In simplified terms, any gain or loss recognized on an intercompany sale is unrealized until the related asset is sold to a third party or consumed in the operation of the consolidated entity. As the parent and the subsidiary(ies) are viewed as a single economic entity and an entity cannot record a gain or loss on a transaction with itself, unrealized intercompany profits (losses) on assets that remain in the consolidated group must be eliminated on consolidation.

There are three common scenarios where intercompany profits (losses) may exist and each scenario is subject to a different treatment on elimination:

	Description	Treatment
Scenario 1	Profits (losses) that were recognized in the single entity statements of the parent or subsidiary(ies) in the current period and remain unrealized at the end of the current period.	Remove from current income by adjusting current expenses or revenues.
Scenario 2	Profits (losses) that were recognized in the single entity statements of the parent or subsidiary(ies) in a previous period and remain unrealized at the end of the current period.	Remove from both the opening and closing[1] retained earnings of the company who recorded the profits (losses) in its books.

[1] *In practice, no adjustment is required to the closing retained earnings of the combined entity because the adjustment made to the opening retained earnings will flow through to the closing balance at year-end; unless some part of the profits (losses) is realized during the current period in which case the realized portion will be recognized in current income causing the adjustment to the opening retained earnings (i.e., 100% of the unrealized amount from prior periods) to differ from that of the ending retained earnings (i.e., the remaining unrealized portion).*

	Description	Treatment
Scenario 3	Profits (losses) that were recognized in the single entity statements of the parent or subsidiary(ies) in a previous period and were unrealized at the beginning of the current period, but became realized during the current period.	Remove from opening retained earnings of the company who recorded the profits (losses) in its books and add back to consolidated income by adjusting current expenses or revenues.

In addition, depending on the underlying assets of which the unrealized profits (losses) relate to, the elimination procedures are slightly different. For this reason, it is useful to classify such profits (losses) into three groups:

Unrealized profits (losses) on intercompany sales of assets with unlimited lives (e.g., land) Unrealized profits (losses) on intercompany sales of current assets (e.g., inventory held for resale)	Sale of assets with unlimited lives and current assets are treated the same for elimination purposes. The realization of the profit (loss) takes place in a single accounting period. Therefore, the unrealized profits (losses) will be deferred until the assets are sold to a third party at which point, they are recognized in net income in the consolidated financial statements.
Unrealized profits (losses) on intercompany sales of depreciable assets (e.g., equipment, natural resources and intangibles)	The unrealized profits (losses) from the intercompany sale of depreciable assets are realized through the use of the assets (i.e., recognized over the same period as the assets are being amortized). For this reason, the realization of profit (loss) will occur over several accounting periods.

Commonly, profits (losses) arising from sales made by the parent to the subsidiary(ies) are referred to as downstream profits (losses) and profits (losses) arising from sales made by the subsidiary(ies) to the parent are referred to as upstream profits (losses).

Downstream Transaction

- The elimination is charged to the parent who recognized the profits (losses) in its books.
- 100% of any unrealized profits or losses are removed from the consolidated net income.
- NCI in income is not impacted.

Upstream Transaction

- The elimination is charged to the subsidiary(ies) who recognized the profits (losses) in its books.
- 100% of any unrealized profits or losses are removed form the consolidated net income.
- NCI in income is affected as the non-controlling shareholders have an interest in the profits (losses) of the subsidiary(ies). Hence, the elimination is allocated on a pro rata basis to the parent and the NCI.

Note! If the parent owns less than 100% of the subsidiary(ies), there is an NCI associated with any upstream profit (loss) elimination. In particular, there would be a pro rata split for the controlling and non-controlling interests. However, it would not impact the calculation or disclosure of the consolidated expenses and revenues.

Examples used in this guide focus on upstream transactions to illustrate the NCI calculation. Adjustments for downstream transactions are the same as upstream transactions, but without the NCI consideration.

Treatment of Unrealized Intercompany Profits (Losses) – Scenarios 1 and 2

If any assets that have been transferred within the consolidated group are still owned or held by the purchasing company, their carrying amounts may include unrealized intercompany gains (losses). These gains (losses) could consist of gains (losses) on disposal of non-current assets, and profits (losses) on sale of inventory items, recognized by the selling company. In the year of the transaction, these unrealized gains (losses) would have to be eliminated in the consolidated financial statements. In effect, the asset account would be adjusted to reflect the original value carried in the records of the selling company.

Note!

- The amount eliminated should not be impacted by the presence of an NCI. In other words, the entire unrealized profits (losses) will be eliminated, regardless of whether the parent owns 100% of the subsidiary. However, the elimination will be charged proportionally to the controlling and non-controlling interests.
- An intercompany loss from the sale of an asset or inventory could be an indication of decline in the value of the relevant asset. Therefore, even though the intercompany loss is eliminated in full, the applicable asset may require write down by the selling company to reflect the reduction in value.
- As part of the transaction, the purchasing company may incur costs that may increase the carrying value of the asset (e.g., freight cost paid to a third party). Such costs would be recognized in the consolidated financial statements and would not be eliminated upon consolidation.
- Income tax payments or recoveries resulting from the transfer should be recognized as an asset or a liability in the consolidated financial statements until the profit (loss) is recognized by the combined entity.

As discussed above, the initial elimination adjustment is only made in the consolidated financial statements. Given that, in subsequent periods until the realization of the unrealized profit (loss), the single entity records would still carry the unadjusted amounts (i.e., the purchasing company's asset would be recorded at the transaction amount and the selling company's retained earnings would contain the unrealized profit (loss)). Therefore, an adjustment would be required to eliminate the same unrealized gains (losses) from opening retained earnings. The corresponding adjustment would be made to the related assets that were transferred as part of the original transaction.

The table below provides a summary of how gains and losses will impact opening retained earnings.

	Gains	Losses
Opening Retained Earnings	Debit Opening Retained Earnings	Credit Retained Earnings

An exception exists for regulated public utilities. If either party of the consolidated group (parent or subsidiary) manufactures or constructs facilities for a regulated public utility, any intercompany gains (losses) would be realized in the consolidated financial statement to the extent the government regulatory body recognizes the transfer price on the facility for rate making purposes.

Example 8 – Unrealized Intercompany Profits on Upstream Sale of Current Assets, Scenarios 1 & 2

Company A owns 80% of Company B. During Year 1, Company B sold 100 coffee mugs at $12 each to Company A (parent) for resale. The mugs had a unit cost of $10 for Company B. As such, Company B recorded in its books sales revenue of $1,200 (100 × $12), cost of goods sold of $1,000 (100 × $10) and the resulting profit of $200 from this intercompany transaction. Company A recorded the inventory at the purchase price of $1,200 and 70% of the inventory was sold to a third party two years later.

Assessment:

Year 1 (profit recognized in current year, but asset not sold at current year-end)

At year-end, the consolidated income statement would report an intercompany gain of $200 as recorded by Company B. This gain would not be considered realized as the inventory remained within the consolidated group at year-end
(i.e., had not been sold to an independent third party) and therefore would have to be eliminated. The following entry would have to be made to eliminate the intercompany transactions (see Step 8) and unrealized profits:

Sales revenue (Company B)	1,200	
Cost of goods sold (Company B)		1,000
Inventory (Company A)		200

Note that by eliminating the unrealized profit, the carrying value of the inventory will be adjusted back to $1,000 ($1,200 - $200) in the consolidated financial statements.

Example 8 – Unrealized Intercompany Profits on Upstream Sale of Current Assets, Scenarios 1 & 2 *(Continued from previous page)*

Non-controlling Interest

Since the decrease in net income ($200) is related to the elimination of unrealized upstream profit, the effect on income will be shared pro rata by the controlling and non-controlling interest. Therefore, NCI in the consolidated net income will be reduced by $40 ($200 × 20%) and the controlling interest in the consolidated net income will be decreased by $160 ($200 × 80%).

If this was a downstream transaction, there would be no impact on NCI and the same adjustments as presented above would be made, except that the revenue and cost of goods sold adjustments would be made to the parent and the inventory adjustment to the subsidiary.

Year 2 (unrealized profit recognized in previous year, but asset remain unsold at current year-end)

The unrealized profit that was recognized in income of Year 1 would be recorded in the opening retained earnings of Company B in Year 2. Therefore, an elimination entry is required to take such profit out of the opening retained earnings of Company B and in turn reduce inventory that is also overstated by $200.

Retained earnings, opening (Company B)	200	
Inventory (Company A)		200

Example 9 – Unrealized Intercompany Profits on Upstream Sale of Depreciable Assets, Scenarios 1 & 2

Company A owns 80% of Company B. On December 31, 20X1 (year-end date), Company B sold a piece of equipment to Company A for $100,000. The equipment had a carrying value of $80,000. Therefore, Company B realized a $20,000 gain on this transaction. Company A intended to keep the equipment for its remaining useful life of five years.

Assessment:

Year 1

As part of this transaction, Company A would have recorded the equipment at $100,000 in its records, while Company B would have removed the equipment from its record and recorded the $20,000 gain on the transaction. Therefore, an elimination entry will be required in the first year to eliminate the unrealized profit and adjust the carrying value of the equipment back to $80,000 on the consolidated balance sheet.

Gain on sale of equipment (Company B)	20,000	
Equipment, net (Company A)		20,000

No adjustment is required for amortization as the equipment was sold on the year-end date (i.e., subsequent to the intercompany purchase, Company A had not used the asset in that year).

Non-controlling Interest

Since the reversal of the gain ($20,000) is related to the elimination of unrealized upstream profit, the effect on income will be shared pro rata by the controlling and non-controlling interest. Therefore, NCI in the consolidated net income will be reduced by $4,000 ($20,000 × 20%) and the controlling interest in the consolidated net income will be decreased by $16,000 ($200 × 80%).

If this was a downstream transaction, there would be no impact on NCI and the same adjustments as presented above would be made, except that the equipment adjustment would be made to the subsidiary and the gain on sale adjustment to the parent.

Example 9 – Unrealized Intercompany Profits on Upstream Sale of Depreciable Assets, Scenarios 1 & 2 *(Continued from previous page)*

Year 2

As part of Company B's opening retained earnings in Year 2 will be the $20,000 unrealized gain on the sale of the equipment. Given that unrealized profit on sale of depreciable asset should be recognized over the useful life of the asset, such gain in opening retained earnings should be eliminated. Specifically, the entire amount would be eliminated on January 1, 20X2 as the asset had not yet been used by Company A (i.e., no amortization taken).

Opening retained earnings (Company B)	20,000	
Equipment, net (Company A)		20,000

As at December 31, 20X2, an adjustment needs to be made to account for the difference in amortization expense that would have been recorded in Company A's records during the year. Company A would have recorded amortization expense of $20,000 ($100,000 ÷ 5). However, amortization expense for the combined entity should have been $16,000 (80,000 ÷ 5). Therefore, the following adjustment would be required.

Equipment, net	4,000	
Amortization expense		4,000

Non-controlling Interest

Since Company A only owns 80% of Company B and this is an upstream transaction, there would be an impact to the NCI. Accordingly, the adjustment to opening retained earnings would reduce opening NCI on the consolidated balance sheet by $4,000 (20% × $20,000) and the opening controlling interest (i.e., opening consolidated retained earnings) by $16,000 (80% × 20,000). The reduction in amortization expense would increase NCI in the consolidated net income by $800 (20% × $4,000) and the controlling interest by $3,200 (80% × $4,000).

Again, as discussed in previous examples, if this was a downstream transaction, there would be no impact on the NCI.

Example 9 – Unrealized Intercompany Profits on Upstream Sale of Depreciable Assets, Scenarios 1 & 2 *(Continued from previous page)*

Year 3

At December 31, 20X3, a similar entry would have to be made to adjust opening retained earnings and the equipment amount for the unamortized portion of the unrealized gain. As such, the adjustment to opening retained earnings in Year 3 would be reduced by the previous years' amortization adjustments ($20,000 - $4,000). Such cumulative amortization adjustment represents the portion of the unrealized gain that become realized subsequent to the original intercompany purchase. The required entry would be as follows:

Opening retained earnings (Company B)	16,000	
Equipment, net (Company A)		16,000

Consistent with Year 2, an adjustment would have to be made to the consolidated amortization expense as follows:

Equipment, net	4,000	
Amortization expense		4,000

Non-controlling Interest

Similar to Year 2, the adjustments to opening retained earnings and amortization expense will be allocated between the parent and the NCI on a pro rata basis.

Note that the same entries would have to be prepared each year until the equipment is fully amortized or sold. If the equipment is sold to a third party, the entire unamortized balance of the unrealized profit would become realized in the period of sale.

Treatment of Realized Intercompany Profits (Losses) that were Unrealized in Prior Periods – Scenario 3

In most circumstances, eventually these unrealized profits and losses will become realized. When the assets transferred between the parent and the subsidiary(ies) are sold to a party outside the consolidated group, the entity selling the assets would record that sale and the related profit, which would then be picked up in the consolidated financial statements. At that point, the consolidated financial statements should also recognize the previously unrealized gains (losses) that had been eliminated on consolidation in prior period(s) relating to the assets sold.

Example 10 – Realized Intercompany Profits on Upstream Sale of Current Assets, Scenario 3

This example uses the same facts from Example 8 and accounts of the subsequent sale of the inventory to a third party. Recall from the previous example, Company A (parent) purchased inventory from Company B (subsidiary) in Year 1 and sold 70% of that inventory to a third party in Year 3.

Assessment:

<u>Year 3 (unrealized profit recognized in previous year and asset sold in current year)</u>

The unrealized profit that was recognized in income of Year 1 would be recorded in the opening retained earnings of Year 3, since none of the inventory was sold during Year 2. Therefore, an elimination entry is required to take such profit out of the opening retained earnings of Company B.

As only 70% of the inventory was sold during Year 3, the ending inventory would remain overstated by 30% of the unrealized profit related to the unsold goods remaining in inventory. As such, a portion of the elimination entry would reduce the carrying amount of the inventory to correct the overstatement.

Furthermore, current year's cost of goods sold would also be overstated as Company A would have recorded cost of goods sold based on the overstated opening inventory. Therefore, the elimination entry would have to reduce the current year's cost of goods sold. This adjustment would in turn increase current year's income reflecting the 70% of unrealized profit that has been realized during the year.

Retained earnings, opening (Company B)	200	
Inventory ($200 × 30%) (Company A)		60
Cost of goods sold ($200 × 70%) (Company B)		140

Non-controlling Interest

Since the reduction in cost of goods sold is related to the realization of previously unrealized upstream profit, the effect on income will be shared pro rata by the controlling and non-controlling interest. Therefore, NCI in the consolidated income statement will be increased by $28 ($140 × 20%) and the controlling interest in the consolidated net income will be increased by $112 ($140 × 80%). Note, the $60 related to remaining inventory does not require an adjustment because it had been accounted for under Scenario 1 in Example 8.

If this was a downstream transaction, there would be no impact on NCI and the same adjustments as presented above would be made, except that the cost of goods sold and opening retained earnings adjustments would be made to the parent and the inventory adjustment to the subsidiary.

Preparation of Consolidated Financial Statements

Final Step – Distribution of the Subsidiary(ies)'s Retained Earnings

The final task before the consolidated financial statements can be prepared, is the allocation of the remaining balance of the retained earnings since acquisition to the NCI in the balance sheet and to consolidated retained earnings attributable to the parent.

Example 11 – Preparation of Consolidated Financial Statements

Company A acquired 80% of Company B on January 1, 2019 for $3,000,000 in cash. At that time, Company B's shareholders' equity was composed of common shares of $1,000,000 and retained earnings of $1,500,000. Company B did not declare any dividends in 2019 and 2020. Currently, Company A and B are in the process of preparing their consolidated financial statements as at December 31, 2020. On December 31, 2020, Company B's retained earnings were $2,000,000.

Comparison of Fair Values to Carrying Values at Acquisition

At the date of acquisition, all of the identifiable assets and liabilities of Company B had fair values that were equal to their carrying values, except for the items shown below:

	Carrying Value	Fair Value	Fair Value Change	
Equipment	533,340	800,000	266,660	*Note 1*
Inventory	300,000	200,000	(100,000)	*Note 2*

Note 1: The equipment has a remaining useful life of 10 years and therefore has an annual amortization of fair value increase of $26,666.

Note 2: All of the inventory was sold as of December 31, 2019. Thus, the entire fair value change was realized in 2019.

Example 11 – Preparation of Consolidated Financial Statements *(Continued from previous page)*

Post-acquisition Intercompany Transactions

The following upstream transactions occurred since January 1, 2019:

Land

Company B sold a piece of land to Company A for $100,000 during 2014. The land had a book value of $80,000. As at December 31, 2020, Company A still owns the land. An unrealized upstream intercompany profit of $20,000 occurred as part of this transaction, which is included in Company B's 2020 opening retained earnings.

Inventory

During 2019, Company B sold 100,000 units of inventory to Company A which had a cost of $80,000. At the end of 2019, Company A still had $50,000 of that inventory on hand (i.e., half of that inventory was sold to third parties during 2019). The remaining inventory was sold in 2020. For this reason, Company B's 2020 opening retained earnings contains an unrealized upstream profit of $10,000 (($100,000 - $80,000) x ($50,000 / $100,000)).

Building

On January 2, 2019, Company B sold a building to Company A for $500,000. The original cost of the building was $700,000 and, at the time of the intercompany sale had accumulated amortization of $300,000. At that time the building had an estimated useful life of 5 years with no salvage value. As a result, Company B recorded an intercompany gain of $100,000 ($500,000 - ($700,000 - $300,000)) in 2019.

Company A records amortization on this building of $100,000 ($500,000 ÷ 5) a year based on the purchase price. However, since this was an intercompany sale, amortization for the consolidated financial statements should be based on Company B's carrying value of $400,000 ($700,000 - $300,000); therefore, amortization should be $80,000 ($400,000 ÷ 5) a year instead. For this reason, an annual adjustment is required to decrease the amortization by $20,000 ($100,000 - $80,000). The decreases in amortization over the next 5 years would in turn realize the intercompany gain on the sale of building by the end of its useful life (i.e., $100,000 gain = 5 years × $20,000 amortization adjustment). Therefore, as at January 1, 2020, Company B's opening retained earnings would include an unrealized intercompany gain of $80,000 (i.e., $100,000 unrealized gain - $20,000 realized portion due to 2019 amortization).

Example 11 – Preparation of Consolidated Financial Statements *(Continued from previous page)*

Assessment:

Allocation of Company B's Retained Earrings

Company B's retained earnings at January 1, 2020	2,000,000
Less: retained earnings present at acquisition or January 1, 2019 **(Step 2)**	(1,500,000)
Balance since acquisition to January 1, 2020	500,000
Adjustments for fair value changes **(Step 6)**:	
Amortization of fair value increase on equipment (1 year × $26,666)	(26,666)
Realization of fair value decrease on inventory	100,000
Adjustments for unrealized intercompany profits **(Step 10)**:	
Land	(20,000)
Opening inventory	(10,000)
Building	(80,000)
Adjusted balance since acquisition	463,334
Less: non-controlling interest (20% × $463,334)	(92,667)
Consolidated retained earnings (80% × $463,334)	370,997

Retained Earnings Distribution Entry

Using the information calculated above, the following journal entry would be made to distribute Company B's retained earnings since acquisition:

Retained earnings, adjusted opening (Company B)	463,334	
Non-controlling interest (balance sheet)		92,667
Consolidated retained earnings		370,997

Once the 10 steps described in this guide are dealt with and the above retained earnings distribution is performed, all the necessary preparation needed to prepare the consolidated financial statements are completed. Refer to "Appendix A – Summary of Definitional Calculations" for an alternative method in computing the required balances for various accounts to be reported on the consolidated financial statements, instead of the journal entry approach.

Consolidated Income Statements

After the parent's and the subsidiary(ies) income statements are combined on a line-by-line bases and all elimination adjustments have been made, the total revenues less the total expenses will represent the net income of the consolidated entity. If NCI is presented, it will be deducted from the subsidiary(ies)'s income to arrive at the controlling interest in the consolidated net income. NCI is not deducted as an expense.

The NCI is based on the subsidiary(ies)'s reported income, adjusted for:

- Realizations of fair value changes that have taken place during the current period;
- Realizations of previously unrealized upstream profits (initially recognized in a prior period); and
- Upstream profits recognized during the current period, but unrealized at the end of the current period.

Example 11.1 – Preparation of Consolidated Financial Statements (Continued)

This example will continue with the information provided in Example 11.

The following is extracted from the trial balances of Company A and B at December 31, 2020 for the income statement accounts.

	Company A		Company B	
	DR	CR	DR	CR
Sales		2,500,000		1,500,000
Dividend revenue (from Company B)		70,000		
Interest revenue (from Company B on loan receivable)		24,000		
Cost of goods sold	1,000,000		500,000	
Amortization expense	400,000		250,000	
Interest expense (Company B's balance includes $24,000 of interest paid to Company A)	84,000		50,000	
Operating expenses	600,000		400,000	
Net Income		510,000		300,000

Intercompany Sale

During 2020, Company B sold $300,000 in inventory to Company A, expensed the cost of $200,000 in cost of goods sold and recognized a profit of $100,000 on the transaction. All of that inventory remained in Company A's closing inventory balance at year-end.

Example 11.1 – Preparation of Consolidated Financial Statements *(Continued from previous page)*

Assessment: The consolidated income statement of Company A would be prepared as follows:

Consolidated Income Statement

For the year ended December 31, 2020

Sales ($2,500,000 + $1,500,000 - $300,000) (Elimination of intercompany transactions – inventory sales) **(Step 8)**	3,700,000
Interest revenue ($24,000 - $24,000) (Elimination of intercompany transactions – interest) **(Step 8)**	-
Dividend revenue ($70,000 - $70,000) (Elimination of intercompany dividend) **(Step 9)**	-
Total revenues	3,700,000
Cost of goods sold ($1,000,000 + $500,000 - $300,000 + $100,000 - $10,000) (Elimination of intercompany transactions – inventory sales, elimination of unrealized profit on 2015 inventory sales and realization of profits on opening inventory related to 2014 inventory sales) **(Steps 8 & 10)**	1,290,000
Amortization expense ($400,000 + $250,000 - 20,000 + 26,666) (realization of gain on sale of building and amortization of fair value increase in equipment) **(Steps 6 & 10)**	656,666
Interest expense ($84,000 + $50,000 - $24,000) (Eliminated intercompany transactions – interest) **(Step 8)**	110,000
Operating expenses ($600,000 + $400,000)	1,000,000
Total expenses	3,056,666
Consolidated net income of the enterprise	643,334
Non-controlling interest **(Note 1)**	(40,667)
Controlling interest in consolidated net income	602,667

Note 1 – Calculation of net income attributable to NCI

Company B's reported net income	300,000
Amortization of fair value increase on equipment	(26,666)
Adjustments for unrealized profits:	
Opening inventory (2014 upstream sales)	10,000
Closing inventory (2015 upstream sales)	(100,000)
Realized portion of gain on upstream sale of building	20,000
Company B's adjusted net income	203,334
Non-controlling percent	20%
Non-controlling interest in consolidated net income	40,667

Consolidated Statement of Retained Earnings

Example 11.2 – Preparation of Consolidated Financial Statements (Continued)

The following is the equity accounts of Company A and B, extracted from their trial balances at December 31, 2020.

	Company A		Company B	
	DR	CR	DR	CR
Common shares		1,500,000		1,000,000
Retained earnings, opening		2,340,000		2,000,000
Dividend declared	100,000		87,500	

Assessment: The consolidated statement of retained earnings of Company A would be prepared as follows:

Consolidated Statement of Retained Earnings

For the year ended December 31, 2020

Consolidated retained earnings, opening – January 1, 2020 (2,340,000 +$370,997 (from Example 11))		2,710,667
Consolidated net income of the enterprise (from Example 11.1)	643,334	
Less: non-controlling interest in consolidated net income (from Example 11.1)	(40,667)	602,667
Dividends declared (Company A only)		(100,000)
Consolidated retained earnings, ending – December 31, 2020		3,213,334

Consolidated Balance Sheet

Example 11.3 – Preparation of Consolidated Financial Statements (Continued)

The following is the balance sheet side, except for the equity accounts, of Company A's and B's trial balance at December 31, 2020.

The non-controlling interest at acquisition was calculated using the Fair Value of the Enterprise Acquired - Direct Measurement of Fair Value approach. The per-share purchase price paid by Company A at acquisition represented the fair value per share of Company B. Therefore, the fair value of Company B was $3,750,000 ($3,000,000 ÷ 80% × 100%).

	Company A		Company B	
	DR	CR	DR	CR
Cash	500,000		600,000	
Accounts receivable **(Note 1)**	450,000		752,500	
Inventory (Company A's balance includes inventory of $300,000 purchased from Company B)	400,000		650,000	
Long-term note receivable **(Note 2)**	500,000		750,000	
Investment in Company B – at cost	3,000,000			
Land (purchased from Company B)	100,000			
Property, plant and equipment, net (Company A's balance includes building purchased from Company B)	650,000		1,600,000	
Accounts payable **(Note 1)**		350,000		90,000
Long-term liabilities **(Note 2)**		1,000,000		1,050,000

Note 1 – Company B's accounts receivable contain a receivable from Company A of $300,000 for the inventory sold to Company A during the 2020. Company A's accounts payable contain a corresponding payable to Company B.

Note 2 – Company A's long-term note receivable consists of a note receivable from Company B of $500,000. The corresponding balance is included in Company B's long-term liabilities.

Example 11.3 – Preparation of Consolidated Financial Statements *(Continued from previous page)*

Assessment: The consolidated balance sheet of Company A would be prepared as follows:

Consolidated Balance Sheet

As at December 31, 2020

Cash ($500,000 + $600,000)	1,100,000
Accounts receivable ($450,000 + $752,500 - $300,000) (elimination of intercompany balances) **(Step 5)**	902,500
Inventory ($400,000 + $650,000 - $100,000) (elimination of unrealized profit on 2020 inventory sales) **(Step 10)**	950,000
Current assets	2,952,500
Long-term note receivable ($500,000 + $750,000 - 500,000) (elimination of intercompany balances) **(Step 5)**	750,000
Investment in Company B ($3,000,000 - $3,000,000) (elimination of parent's investment account) **(Step 1)**	-
Land ($100,000 - $20,000) (elimination of unrealized gain on sale of land) **(Step 10)**	80,000
Property, plant and equipment ($650,000 + $1,600,000 + $213,328 - $60,000) **(Steps 6 & 10) (Note 1)**	2,403,328
Goodwill	1,083,340
Total assets	**7,269,168**
Accounts payable ($350,000 + $90,000 - $300,000) (elimination of intercompany balances) **(Step 5)**	140,000
Long-term liabilities ($1,000,000 + $1,050,000 - $500,000) (elimination of intercompany balances) **(Step 5)**	1,550,000
Total liabilities	**1,690,000**
Shareholders' equity:	
Common shares (Company A only)	1,500,000
Retained earnings (from Example 11.2)	3,213,334
Non-controlling interest **(Step 4) (Note 2)**	865,834
Total shareholders' equity	**5,579,168**
Total liabilities and shareholders' equity	**7,269,168**

Example 11.3 – Preparation of Consolidated Financial Statements ***(Continued from previous page)***

Note 1 – The fair value increase for the equipment of $266,660 would have been recorded at the date of acquisition in the consolidated financial statements (see Example 11). Subsequent to acquisition, the consolidated group would have recorded the annual amortization of this fair value change for the two years since the acquisition (i.e., 2 years × $26,666). Therefore, the unamortized fair value increase at December 31, 2020 would be $213,328 ($266,660 - $53,332).

The $60,000 is to adjust the building that was sold from Company B to Company A to the value Company B would have recorded at this time if the sale had not occurred. At the time of the intercompany sale, an unrealized gain of $100,000 was recognized by Company B. In subsequent periods, the realization of such gain in the consolidated net income is based on the pattern of the amortization of the building (i.e., two years' worth of annual realization, or 2 × $20,000). Therefore, the unrealized portion as at December 31, 2020 would be $60,000 ($100,000 - $40,000).

Note 2 – There are two basic approaches that can be used to calculate the NCI in the consolidated balance sheet. Only one approach is shown in the calculations below. The other approach that can be used, is a more direct approach that uses the parent company's shareholders' equity and adjusts it for any unrealized fair value changes and unrealized upstream profits. This is similar to the approach used to calculate the non-controlling interest in the income statement. The adjusted shareholders' equity will then by multiplied by the NCI percentage.

Non-controlling interest of fair value of the investment ($3,750,000 × 20%)	750,000
Adjustment for dividends paid to non-controlling shareholders ($87,500 × 20%)	(17,500)
Allocation of retained earnings since acquisition (from Example 11)	92,667
Non-controlling interest in consolidated net income (from Example 11.1)	40,667
Non-controlling interest – balance sheet	865,834

Consolidated Cash Flow Statement

In general, the procedures required to prepare a consolidated cash flow statement are not much different from those required to prepare a single entity cash flow statement. There are a few procedures that are unique to consolidated cash flows, which are discussed below.

Single Entity Cash Flow	Consolidated Cash Flow
• Dividends shown will be the same amount as shown in the statement of retained earings. • Shares acquired directly from subsidiary or from a non-controlling shareholder are shown as an outflow in the single entity cashflow.	• The cash flow from operating activities is comprised of <u>both</u> controlling and non-conroling interest share of income. • Dividends shown in the cash flow may not be consistent with the figure shown in retained earnings. The cashflow will show all dividends paid, where the consolidated retained earnings may only show those dividends paid to the parent company shareholders. • Dividends paid to NCI are presented separately under financing activities. • Shares acquired directly in the subsidiary for cash are considered to be an intercompany transaction and would be eliminated and would not appear on the consolidated cash flow. If the shares were aquired from a non-controlling shareholder they would be shown as an outflow on the consolidated cash flow.

ASPE 1540 *Cash Flow Statement* provides general guidance on the preparation and presentation of the cash flow statement. In the year of acquisition, the consolidated entity should refer to ASPE 1540.38-40 for specific guidance with respect to business combinations.

Additional Aspects of Consolidation

Reciprocal Shareholdings

Reciprocal shareholdings occurs when a subsidiary owns shares in the parent or when two subsidiaries own shares in each other. The elimination of the reciprocal shareholdings held among subsidiaries on consolidation can result in a difference between the investment cost on the purchasing company's records and the carrying amount of the equity securities on the issuing company's records. The difference will be allocated between the parent and the NCI on a pro rata basis.

The main problem created when a subsidiary owns a portion of the parent's shares or subsidiaries hold shares in each other, relates to the computation of the proportionate equities in the income and retained earnings of the consolidated entities. In order to determine the parent's share of the subsidiary's income, the subsidiary's income needs to be determined first. However, since the subsidiary owns equity stake in the parent, the computation of the subsidiary's income would require determination of the subsidiary's share of the parent's income. This ends up creating a circular process. While this problem can be solved by the application of algebraic formulas, which involve solving multiple variables simultaneously, such application is not a common accounting approach and therefore may add difficulty in arriving at the solution.

Note! Any dividends received by the subsidiary(ies) on these reciprocal shareholdings are excluded from the determination of consolidated net income and offset against the amount of dividends distributed by the issuing company.

The shares owned by the subsidiary(ies) in the parent should be presented on consolidation as if the parent had purchased its own shares. The consolidated balance sheet should reflect the issued share capital of the parent in full (i.e., including any shares held by the subsidiary(ies)) and, as separate line item under the equity section, the deduction for the cost of shares held by the subsidiary(ies).

Example 12 – Subsidiary Owning Shares in Parent

On January 1, 20XX, both Companies A and B were incorporated. Immediately after incorporation, Company A (parent) acquired 80% of Company B and Company B (subsidiary) acquires 10% of Company A. Given that these companies were newly incorporated on the acquisition date, there are no fair value changes, goodwill or retained earnings at acquisition that require adjustment for consolidation purposes. On December 31, 20XX, the following information is available for Companies A and B:

	Company A	Company B
Investment in Company B	320,000	
Investment in Company A		60,000
Net assets (excluding investment in each other)	1,280,000	1,140,000
Total net assets	**1,600,000**	**1,200,000**
Common shares	600,000	400,000
Retained earnings	1,000,000	800,000
Total equities	**1,600,000**	**1,200,000**

There were no changes of either company's common shares since the acquisition. There were also no intercompany transactions during the year.

Assessment: The same consolidation procedures introduced earlier in this guide apply to the situation of reciprocal shareholdings, except for the challenge presents in the allocation of the combined retained earnings, or $1,800,000 ($1,000,000 + $800,000), between Companies A and B.

As discussed, simultaneous equations will have to be used to determine the appropriate allocation. The following equations will represent the respective interest of the two entities in the retained earnings accounts:

Company A = $1,000,000 + (80% × Company B)

Company B = $800,000 + (10% × Company A)

Example 12 – Subsidiary Owning Shares in Parent *(Continued from previous page)*

To solve the two unknown variables in these equations, we will have to substitute one of the variables as follows:

Company A = $1,000,000 + (80% × ($800,000 + (10% × Company A))

Company B = $ 800,000 + (10% × ($1,000,000 + (80% × Company B))

Company A = $1,782,609

Company B = $ 978,261

Note that when the two amounts are added together, the total of $2,760,870 is greater than the actual combined retained earnings of $1,800,000. This reflects the fact that each amount contains a proportionate share of the other balance. This duplication cannot be recorded in the completed financial statements; therefore, the NCI in each company's balance will have to be removed to arrive at the appropriate consolidated retained earnings to be reported.

Non-controlling Interest

Company A's balance includes a 10% NCI that is also included in Company B's balance. To arrive at the appropriate consolidated retained earnings (attributable to the controlling interest) this figure must be removed.

Consolidated retained earnings ($1,782,609 - ($1,782,609 × 10%))	1,604,348

Company B's balance contains a controlling interest that is reflected in the preceding consolidated retained earnings balance. To arrive at the NCI in retained earnings since acquisition, the controlling interest must be removed.

Controlling interest in Company B's retained earnings ($978,261 × 80%)	782,609
NCI in retained earnings since acquisition ($978,261 - $782,609)	195,652

To arrive at the total NCI to be presented as a single line item in the consolidated balance sheet, the NCI in the common shares of Company B needs to be added to the NCI in retained earnings since acquisition.

NCI in Company B's common shares ($400,000 × 20%)	80,000
NCI in retained earnings since acquisition	195,652
Total NCI	275,652

Example 12 – Subsidiary Owning Shares in Parent *(Continued from previous page)*

Based on the above, the net assets and the shareholders' equity balances of the consolidated financial statement will show the following:

Consolidated net assets (1,280,000 +1,140,000)	2,420,000
Common shares (Company A only)	600,000
Consolidated retained earnings	1,604,348
Non-controlling interest	275,652
Shares in Company A held by Company B (10% ×$600,000)	(60,000)
Total Shareholders' Equity	2,420,000

The same algebraic formulas would be used in circumstances where the subsidiaries own shares in each other. The only difference arises when the parent's retained earnings formula is established. The parent would have to account for its share in all the subsidiaries' retained earnings, as illustrated in the following example.

Example 13 – Subsidiary Owning Shares in Each Other

On January 1, 20XX, Companies A, B and C were incorporated. Immediately after incorporation, Company A (parent) acquired 80% of Company B and 90% of Company C. On that same date, Company B (subsidiary) acquires 10% of Company C and Company C (subsidiary) acquired 20% of Company B.

On December 31, 20XX, the following information is available for Companies A, B and C:

	Company A	Company B	Company C
Retained earnings	100,000	60,000	40,000

Assessment: The following equations will represent the respective interest of the three entities in the retained earnings accounts:

Company A = \$100,000 + (80% × Company B) + (90% × Company C)

Company B = \$ 60,000 + (10% × Company C)

Company C = \$ 40,000 + (20% × Company B)

Example 13 – Subsidiary Owning Shares in Each Other *(Continued from previous page)*

To solve the equations, the variables would be substitute as follows:

Company A = $100,000 + (80% × Company B) + (90% × Company C)

Company B = $ 60,000 + (10% × ($40,000 + (20% × Company B))

Company C = $ 40,000 + (20% × ($60,000 + (10% × Company C))

To solve Company A's (parent's) retained earnings formula, the formulas of the two subsidiaries would be solved first (in the same manner as Example 12). The parent's formula would be simply completed by using the retained earnings amounts determined from solving Company B's and C's formula.

As the subsidiaries do not own any reciprocal interest in the parent, the consolidated retained earnings would be the number derived from solving Company A's formula. No adjustments would be required for NCI included in the subsidiaries as well. In addition, no deduction is required in the consolidated shareholders' equity for shares held by the subsidiaries in the parent.

The NCI would simply be calculated by taking the NCI portion of each subsidiaries' common shares and retained earnings amounts, as determined using the above formulas.

Preferred Shares in Subsidiary

Preferred shares can create another level of complexity when preparing consolidated financial statements, because of the inherent difficulties in determining the appropriate classification and disclosure. Some preferred shares may possess characteristics of both equity and liabilities instruments. For example, certain preferred shares not only have a fixed rate of dividends, but also have a guaranteed redemption value. These types of preferred shares would generally be classified as a liability rather than equity, unless they are issued in a tax planning arrangement and qualify for the equity presentation exemption under APSE 3856.

Non-controlling Interest in Preferred Shares of the Subsidiary(ies)

Normally, preferred shares have a right to the subsidiary's income before the common shares. If these shares are classified as equity and are held by NCI, the parent would calculate its share of the subsidiary's net income after adjusting for dividends paid/declared on these preferred shares. In contrast, if the preferred shares are classified as liabilities, the dividends on these shares are included in the determination of the consolidated net income as a direct expense, rather than a component of the NCI that is deducted from the consolidated net income.

Based on their income provisions (i.e., the dividend feature and the participation right), the preferred shares can be grouped into three types, which would dictate whether the parent would have to adjust the subsidiary's net income before computing their own interest and in turn the impact it will have on the consolidated retained earnings. The table below summarizes the treatment of the two more common types of preferred shares.

Type of Preferred Share	Parent's Share of Subsidiary's Net Income and the Consolidated Retained Earnings	Non-controlling Interest on Consolidated Financial Statements
Non-cumulative based on specified dividend rate	The parent would only adjust the subsidiary's net income if dividends are paid/declared during the period. The impact on retained earnings would be in the current period and only if dividends are paid/declared.	NCI Balance Sheet – Will be impacted by both the NCI in common shares and the NCI in preferred shares of the subsidiary(ies). No arrears impact on the opening NCI portion of retained earnings when dividends are not paid. NCI Income Statement – Will include NCI of preferred dividends paid or declared. If no dividends are declared on preferred shares there is no impact.
Cumulative based on specified dividend rate	The parent would adjust subsidiary(ies)'s net income each year for the preferred shares' entitled dividend rate and consolidated retained earnings would have to be adjusted each year for any arrears dividends not paid.	NCI Balance Sheet – Will be impacted by both the NCI in common shares and the NCI in preferred shares of the subsidiary(ies). NCI in opening retained earnings will include the NCI share of cumulative arrears preferred dividends (preferred shares have priority claim on opening retained earnings). NCI Income Statement – Same impact as non-cumulative shares, but will have an impact each year.

Sometimes, preferred shares may have a right to participate in the income of the subsidiary in addition to the specified dividend rate. The impact on NCI with this type of preferred shares is much more complex than with the two types mentioned above. Both the NCI in the preferred dividends and preferred share's portion of the subsidiary's income would have to be taken into consideration. An impact on the subsidiary's net income would always exists for consolidation purposes, as the preferred shareholder(s) have a right to a proportionate share of the subsidiary's net income (i.e., similar to the rights of non-controlling common shareholders).

Purchase of Preferred Shares by Parent

Consideration has to be given to the elimination of preferred shares when the parent owns preferred shares in the subsidiary(ies). The elimination is relatively simple if the purchase price of the preferred shares paid by the parent equals the parent's share of the carrying value of these shares in the subsidiary(ies), as the amounts would net to a zero balance. However, as soon as the purchase price differs from the carrying amount, the elimination of the share balance of the subsidiary and the related investment account of the parent will create a differential to be allocated.

ASPE does not provide specific guidance on how the differential should be allocated. When common shares are involved, the differential would be allocated to goodwill and fair value changes (as discussed under Step 4). As preferred shares typically have a fixed claim in liquidation, the shareholders are not considered to have a residual interest in the net asset of the subsidiary. Therefore, preferred shares' differentials should not be treated in the same manner as common shares' differentials.

When the parent purchases the subsidiary's preferred shares, those shares are no longer considered outstanding (i.e., held by parties outside the consolidated entity); so in essence, the shares have been retired. In this situation, the differential would be accounted for in accordance with ASPE 3240 *Share Capital*. ASPE 3240 is not discussed in this guide; however, in summary:

- A debit differential would be allocated to retained earnings; and
- A credit differential would be allocated to contributed capital.

Shareholders' Equity Transactions

Post-acquisition equity transactions that involve a change in shareholdings within the subsidiary may affect the proportional equity positions of the parent and the NCI. These transactions could include:

- The parent sells a portion of its shareholdings, or acquires additional shares, in the subsidiary;
- The subsidiary issues new shares (while shares dividends generally have no impact on the relative ownership); and
- The subsidiary repurchases some of its outstanding shares for cancellation.

These transactions are not limited to ones between the parent and existing non-controlling shareholders, but also between the consolidated groups with outside interests. The accounting treatment of a change in ownership interest in, and a loss of control over, a consolidated subsidiary is discussed in more detail below.

Change in Parent's Ownership Interest without Losing Control

Any changes in the ownership interest that do not result in a loss of control would be accounted for as an equity transaction. When such a change occurs, the amount of the increase/decrease in the controlling interest and the carrying amount prior to the change are commonly different.

ASPE 1602 requires the carrying amounts of the controlling and NCI be adjusted to reflect the change in their respective ownership interests in the subsidiary. Any difference between the fair value of the consideration received or paid and the NCI adjustment amount should be recorded directly to equity attributable to the owners of the parent (i.e., the controlling interest). Such change in value should not be included in the determination of the consolidated net income.

Example 14 – Change in Ownership Without Loss of Control
On January 1, 2019, Company A purchased 80% of Company B's outstanding shares for $2 million (80,000 of the 100,000 outstanding shares at a price of $25 per share). On the date of acquisition, Company B had $1.5 million of common shares and $1 million in retained earnings. At that time, all asset and liabilities had carrying values equal to their fair values, except for a patent which had a fair value of $500,000 greater than its carrying value and a remaining useful life of 5 years. The goodwill associated with the acquisition was $500,000. The following three scenarios are based on the case facts above and are independent of each other.
Scenario A – Sale of Shares by Parent
During 2021, Company A sold 10,000 (i.e., 1/8 of Company A's total shareholding) of its shares in Company B to a third party, leaving Company A with 70% ownership in Company B. The shares were sold for $30 per share. Since the acquisition, Company B's change in retained earnings is $500,000. **Assessment:** To determine the amount the controlling interest needs to be adjusted by, first we need to compute the total equity in the subsidiary (attributable to the controlling interest) and the amount of equity transferred as a result of the transaction.

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Example 14 – Change in Ownership Without Loss of Control *(Continued from previous page)*		
Investment Cost		2,000,000
Company B retained earnings since acquisition	500,000	
Amortization of fair value increase on patent (500,000 ÷ 5 × 2)	(200,000)	
Adjusted balance	300,000	
Company A's share in Company B's retained earnings	80%	240,000
Total underlying equity		2,240,000
Fraction transferred		1/8
Equity transferred		280,000

The following adjustment would be required to the controlling interest (held by Company A):

Consideration received (10,000 shares × $30 per share)	300,000
Less: equity transferred to NCI	280,000
Adjustment of the controlling interest	20,0005

This adjustment will not impact the consolidated income statement, but will be reflected in the consolidated statement of retained earnings. The $20,000 will be added to the sum of the opening retained earnings and the controlling interest in the consolidated net income to arrive at the ending consolidated retained earnings balance.

Scenario B – Purchase of Shares by Parent

During 2020, Company A decided to purchase an additional 5,000 of Company B's outstanding shares for $24 per share. The transaction increased Company A's ownership in Company B to 85% (5% increase). At the time of the purchase, the NCI's carrying value was $460,000 and they owned 20,000 of the outstanding shares.

Assessment: In this scenario, the transaction should be accounted for as a simple transfer of equity from the NCI to the controlling interest. It will be required to determine how much of the additional considerations transferred will be adjusted to the controlling interest. This is determined by taking the consideration transferred less the carrying value of the interest transferred.

Cost of equity interest transferred (5,000 × $24)	120,000
Carrying value of interest transferred (5,000 ÷ 20,000 × $460,000)	(115,000)
Adjustment of the controlling interest	5,000

Example 14 – Change in Ownership Without Loss of Control *(Continued from previous page)*
This adjustment will not impact the consolidated income statement, but will be reflected in the consolidated statement of retained earnings. The $5,000 will be deducted from the sum of the opening retained earnings and the controlling interest in the consolidated net income to arrive at the ending consolidated retained earnings balance.
Scenario C – Issuance of Shares by Subsidiary
During 2021, Company B issued 15,000 common shares to investors outside of the consolidated entity for $400,000. **Assessment:** After the issuance of the shares, Company A still holds 80,000 shares; however, the number of total outstanding shares is now 115,000, reducing Company A's ownership interest to 70% (80,000 ÷ 115,000). This scenario would be dealt with in a similar way as Scenario A. In essence, the transaction resulted in a 10% decrease in ownership of the controlling interest, or a transfer of 1/8 of the total equity interest to the NCI. Consistent with Scenarios A and B, this transaction would have no impact on the consolidated income statement. The consolidated retained earnings would be adjusted in the same manner as in Scenario A. In addition, the full proceeds of the share issuance would be added to the consolidated assets; and the NCI would be adjusted for both the equity transferred (1/8 of the total equity interest) and its share of the proceeds (30% of total proceeds).

Cessation of Consolidation – Loss of Control of a Consolidated Subsidiary

A loss in control over a consolidated subsidiary can be caused by a variety of reasons. Common examples include the parent selling a portion of its ownership interest, or the subsidiary issuing additional shares, to investors outside of the consolidated group. However, a loss of control could occur, without a change in absolute or relative ownership, in situations where the subsidiary becomes subject to the control of a government, court, administrator or regulator. A loss of control could also be triggered by a contractual agreement with provisions that confer control on party to the agreement other than the parent. Refer to MNP ASPE 1591 *Subsidiaries* Guide for further guidance on control assessment.

Sometimes control is lost by the parent in two or more arrangements (transactions). However, in certain circumstances multiple arrangements could be considered a single transaction and should be accounted for as such. When one or more of the following situations are present, it may be appropriate to account for the multiple arrangements as one:

- They are entered at the same time or in contemplation of each other.
- The transactions are designed to attain the same commercial goal.

- The occurrence of one or more of the arrangements is dependent of each other.
- One arrangement on its own does not make economic sense, but combined they do.

When control is lost, either through a single or multiple-steps arrangement, consolidation is no longer an acceptable method to account for that investment. As a result, another method of accounting will have to be applied to the investment for subsequent periods. Therefore, this is not just a relative position shift between the controlling and non-controlling interest.

The following procedures are required when a parent loses control over a consolidated subsidiary:

1) Derecognize the former subsidiary's assets (including goodwill) and liabilities at their carrying amounts at the loss-of-control date;
2) Derecognize the carrying amounts of any NCI in the former subsidiary at the loss-of-control date (including any components of equity attributable to the NCI);
3) Recognize, in connection with the transaction that resulted in the loss of control:
   - The fair value of the consideration received, if any; and
   - The distribution of shares of the former subsidiary to owners in their capacity as owners, if applicable;
4) Recognize any investment retained in the former subsidiary at its carrying amount at the loss-of-control date (i.e., carrying amount will become the new cost); and
5) Recognize any resulting difference as a gain or loss in net income attributable to the parent.

The following diagram compares the accounting treatment of a change in ownership resulting in a loss of control and when control is retained.

Change in Ownership % - Loss of Control

- The difference between the carrying values of the derecongized net assets and any consideration received as part of the transaction is treated as a gain or loss through income of the former parent.

Change in Ownership % - No Loss of Control

- Changes in controlling or non-controlling interests are treated as equity adjustments with no impact on consolidated net income.

Note! If the business of the subsidiary to be disposed of meets the criteria in ASPE 3475 *Disposal of Long-lived Assets and Discontinued Operations* before the disposal date, it should be classified as held for sale. This does not result in cessation of consolidation.

Retained Investment

Loss of control would usually imply that the investor (former parent) has retained a portion of its investment in the former subsidiary (i.e., not all interests have been disposed). As a result, although the investor no longer consolidates the former subsidiary, the investor will have to account for its remaining investment in the former subsidiary.

ASPE 1601 requires that any retained investment and any receivables from or payables to the former subsidiary be accounted for in accordance with the applicable ASPE Sections subsequent to the loss-of-control date. In particular, the classification of the retained investment will dictate the relevant ASPE Sections to be applied:

- ASPE 3051 *Investments* – If the investor is still considered to have a significant influence over the investee, it would be accounted for under this Section.
- ASPE 3856 *Financial Instruments* – If the retained investment meets the definition of a financial asset, it would be accounted for under this Section.
- ASPE 3856 *Financial Instruments*, ASPE 3065 *Leases* or other ASPE Section – Any other rights and obligations would be accounted for under the applicable ASPE Section(s).

The carrying amount used in the parent's non-consolidated financial statements equals the carrying amount of the retained investment in the subsidiary. This is usually the cost of the subsidiary, unless its shares are traded on an active market. If a quoted market price is available, the carrying value would equal the fair value. The carrying value of the subsidiary at the loss-of-control date would be used, on a proportionate basis, to determine the carrying value of the retained investment. This carrying value would become the initial recognition amount, regardless of its subsequent treatment (e.g., as a financial instrument, a significantly influenced investee, etc.).

Example 15 – Accounting for Retained Investment

On December 31, 20XX, Company A sold 50,000 of its 80,000 shares in Company B. The shares were sold for $110 per share. Company B has a total of 100,000 shares outstanding and this transaction resulted in a loss of control by Company A over Company B. The remaining interest in Company B (30,000 shares) provides Company A with significant influence over Company B and Company A's accounting policy choice is to account for its significantly influenced investments at cost in accordance with ASPE 3051. Company A has accounted for its investment in Company B at cost on its single entity financial statements and shows a carrying value of $8,000,000 at the date of disposition.

Right before Company A lost control over Company B, the NCI on the consolidated balance sheet was $1,000,000. Company B's net assets had a carrying value of $7,000,000 (on Company B's records) at the date control was lost. The goodwill acquired as part of the original business combination was recorded at $500,000 at that time and there was an unamortized fair value change of $100,000 remaining on a patent.

Example 15 – Accounting for Retained Investment *(Continued from previous page)*

Assessment:

Since Company A lost control, Company A would no longer consolidate Company B. For this reason, the five steps discussed above under "Required Accounting Treatment" should be applied. This will require Company A to:

(a) Derecognize Company B's net assets
(b) Derecognize the carrying amount of any NCI in Company B
(c) Recognize the fair value of the consideration received
(d) Recognize any investment retained in Company B at its carrying amount
(e) Recognize the resulting difference as a gain or loss in Company A's income

The application of the five steps, at the date of disposition, is as follows:

NCI derecognized	$1,000,000	Step (b)
Fair value of consideration received (50,000 × $110)	$5,500,000	Step (c)
Carrying value of retained interest	$3,000,000	Step (d) *(Note 1)*
Subtotal	$9,500,000	
Carrying value of the subsidiary's net assets	($7,600,000)	Step (a) *(Note 2)*
Gain resulting from derecognition of non-controlling interest	$1,900,000	Step (e)

Note 1

Carrying value of the subsidiary (100% of investment on Company A's books)	$8,000,000
Portion of equity interest retained (30,000 ÷ 80,000)	37.5%
Carrying value of retained interest	$3,000,000

Note 2

Carrying value of subsidiary's net asset (on Company B's books)	$7,000,000
Unamortized fair value change on patent	$ 100,000
Goodwill	$ 500,000
Consolidated carrying value	$7,600,000

In its single entity financial statements, Company A would recognize in net income the $1,900,000 gain resulting from this transaction. Company A would also recognize the opening carrying value of $3,000,000 on its balance sheet for the retained investment in Company B. In periods subsequent to the transaction, Company A would carry the retained investment at cost (in accordance with its accounting policy for significantly influenced investment) on its balance sheet and recognize any investment income (i.e., dividends) earned from Company B in its income statement.

Statements at Different Dates

If the fiscal period of the parent is different than that of the subsidiary(ies) (e.g., parent year-end is December 31 and subsidiary year-end is October 31), it does not mean that the subsidiary(ies), or a portion of the subsidiary(ies), can be excluded from consolidation. It is expected that the subsidiary(ies) can prepare financial statements, for consolidation purposes, that cover the same period as the fiscal period of the parent.

If it is not practicable for a subsidiary(ies) to prepare financial statements that coincide with the fiscal period of the parent, adjustments of significant transactions or events would be required. Unlike IFRS, ASPE does not explicitly define an acceptable time frame for the difference in financial statement dates between the parent and the subsidiary(ies). IFRS explicitly states that the difference should not be greater than three months. *(IFRS 10.B93)* Many entities prepare financial statements on a quarterly basis for management, which would allow the period end to not differ more than three months.

Note! ASPE does not define the criteria to determine what is considered significant. Professional judgement should be applied. Management may consider the following transactions and events for adjustments in the consolidated financial statements, when the single entity financial statements cannot be prepared for the subsidiary(ies) to match the parent's year-end:

- Business combinations
- Asset impairments
- Resolution of contingent liabilities
- Post balance sheet events (of the subsidiary's financial statements)
- Significant devaluation of the functional currency of a foreign subsidiary for the transactions occurring between the subsidiary(ies)'s year-end date and that of the parent
- Consolidation adjustments related to intercompany balances and transactions

To determine if any adjustments are required for the identified significant transactions or events, it will require a careful analysis of the relevant facts and circumstances. When a subsidiary prepared financial statements for a different reporting period than the parent, it will be necessary for management to review the subsidiary's balance sheet to ensure all items are correctly classified as current vs. non-current as at the consolidated group's reporting date.

Disclosure Requirements

If financial statements covering the same period as the parent's financial statements cannot be prepared for the subsidiary(ies), this fact and the period the financial statements covered should be disclosed in the notes of the financial statements.

In addition, any transactions or events that significantly impact the consolidated financial statements, that occurred during the period not covered by the subsidiary(ies)'s financial statements but relevant to the consolidated group's reporting period, should be recorded or disclosed, as appropriate.

Presentation

General Requirement

Consolidated financial statements follow the same disclosure and presentation requirements as non-consolidated financial statements. When consolidated financial statements are prepared by the parent, the entity describes the financial statements as being prepared on a consolidated basis, and each statement shall be labelled as "consolidated".

Reciprocal Shareholdings

The shares owned by the subsidiary(ies) in the parent shall be presented on consolidation as if the parent had purchased its own shares. The entity will present the issued share capital of the parent in full (i.e., including any shares held by the subsidiary(ies)) in the consolidated balance sheet, with the cost of shares held by the subsidiary(ies) shown as a deduction from shareholders' equity.

Income Statement Presentation in Period of an Acquisition or Disposal

Consolidated financial statements will include only the subsidiary's post-acquisition and pre-disposal income.

Non-controlling Interest ("NCI")

Balance Sheet

NCI is presented in the consolidated balance sheet as a single line item within equity, separately from the equity of the owners of the parent.

Income Statement and Statement of Retained Earnings

The consolidated income statement and statement of retained earnings present separately net income attributed to the controlling or non-controlling interest.

Resources

External Resources

- ASPE 1601 can be found in Part II of the CPA Canada Handbook – Accounting
- ASPE 1602 can be found in Part II of the CPA Canada Handbook – Accounting
- Guide to Accounting Standards for Private Enterprises (GASPE) – Chapter 15 – Section 1601 *Consolidated Financial Statements*
- Guide to Accounting Standards for Private Enterprises (GASPE) – Chapter 16 – Section 1602 *Non-Controlling Interests*

Other MNP Technical Guidance

- ASPE 1601 *Consolidated Financial Statements* and ASPE 1602 *Non-Controlling Interests* Snapshot
- ASPE 1582 *Business Combinations* Guide
- ASPE 1591 *Subsidiaries* Guide
- ASPE 3051 *Investments* Guide
- ASPE 3056 *Interests in Joint Arrangements* Guide
- ASPE 3064 *Goodwill and Intangible Assets* Guide
- ASPE 3856 *Financial Instruments* Guide

Appendix A – Summary of Definitional Calculations

Instead of using journal entries to adjust existing account balances in the parent and the subsidiary's records (as illustrated in examples of this guide), a more efficient and effective way to prepare consolidated financial statements is to calculate the required numbers directly and independently using definitional calculations. The following definitions for the relevant financial statement items are provided for this purpose.

Legend:

CV = Carrying Value	A = Asset	NCI = Non-controlling Interest	NI = Net Income
FV = Fair Value	L = Liability	RE = Retained Earnings	CP = Current Period
BS = Balance Sheet	IC = Investment Cost	FS = Financial Statements	PP = Prior Period

Accounts of Consolidated Balance Sheet

Identifiable Assets and Liabilities =

100% of CV of identifiable A/L on parent's records at the BS date

\+

100% of CV of identifiable A/L on subsidiary's records at the BS date

±

100% of the acquisition-date FV increase/decrease for subsidiary's identifiable A/L

±

Amortization or realization of FV increase/decrease on subsidiary's A/L for the period since acquisition to the current BS date

±

Upstream and downstream intercompany profits (losses) that are unrealized as of the BS date

Goodwill* (Bargain Purchase Gain)** =

Sum of the consideration transferred (IC)

\+

Measured value of NCI *(see definition below)*

−

Acquisition-date FV of subsidiary's identifiable net assets

−

Any goodwill impairment losses

* *The amount of goodwill recognized on the consolidated balance sheet will depend on the method used to calculate the NCI at the date of acquisition.*

** *If the resulting amount is negative, it will be recorded as a bargain purchase gain and included in the consolidated income statement.*

Non-controlling Interest

[Proportionate Share of Fair Value Method (based on the Subsidiary's Identifiable Net Assets)]

=

NCI ownership % × [Subsidiary's BS date shareholders' equity ± Unamortized or unrealized balance of the acquisition-date FV changes ± Upstream intercompany profits (losses) that are unrealized as of the BS date]

Non-controlling Interest

[Direct Measurement of Fair Value Method (Based on the Parent's Investment Cost or Quoted Market Prices, if available)]

=

NCI ownership % × [Subsidiary's BS date shareholders' equity ± Unamortized or unrealized balance of the acquisition-date FV changes ± Upstream intercompany profits (losses) that are unrealized as of the BS date + Any balance of goodwill]

Retained Earnings = 100% of parent's RE ± Parent's share of subsidiary's adjusted RE (deficit) since acquisition* − If the acquisition-date NCI was measured using the proportionate share method, 100% of any goodwill impairment ± Downstream intercompany profits (losses) that are unrealized as of the BS date

** The adjustments would be for the accumulated amounts of FV changes that have been realized since acquisition through use or sale. The adjustments to the subsidiary's RE since acquisition would also be for any upstream intercompany profits (losses) that are unrealized as of the BS date. Furthermore, if the acquisition date NCI has been recorded at FV (i.e., direct measurement method), the adjustments would include any goodwill impairment that has been recognized since acquisition.*

Contributed Capital = The contributed capital from the single entity balance sheet of the parent company

Accounts of Consolidated Income Statement

Revenue =

100% of the amount reported in parent's FS

+

100% of the amount reported in subsidiary's FS

−

100% of any intercompany amounts included in parent's or subsidiary's figures

±

100% of any FV changes realized during the period through usage or sale of subsidiary's A*

±

100% of any upstream/ downstream unrealized intercompany profits (losses) that are included in parent's or subsidiary's revenues

±

100% of any upstream/ downstream unrealized intercompany profits (losses) that were unrealized in a PP, but have become realized during CP

** FV amortization and amounts realized through the sale of subsidiary assets prior to the end of their economic life. It would be unusual for FV realizations to be related to revenues; however, it could happen. For example, amortization of a FV change on a long-term receivable would be treated as an adjustment of interest revenue.*

Expenses =

100% of the amount reported in parent's FS

+

100% of the amount reported in subsidiary's FS

−

100% of any intercompany amounts included in parent's or subsidiary's figures

±

100% of any FV changes realized during the period through usage or sale of subsidiary's A*

±

100% of any upstream/ downstream unrealized intercompany profits (losses) that are included in parent's or subsidiary's expenses

±

100% of any upstream/ downstream unrealized intercompany profits (losses) that were eliminated (i.e., unrealized) in a PP, but that have become realized during CP

** FV amortization and amounts realized through the sale of subsidiary assets prior to the end of their economic life.*

Consolidated Net Income of the Enterprise =

100% of parent's NI, excluding dividends received from subsidiary ± 100% of unrealized downstream profits (losses) that are included in parent's income ± 100% of any downstream profits (losses) that were unrealized in a PP, but have become realized during CP ± 100% of the adjusted net income of subsidiary*

** The required adjustments to the subsidiary income are for:*

- *100% of the amounts charged to income for FV changes realized during the period through use or sale.*
- *If the acquisition date NCI has been recorded at FV (i.e., direct measurement method), 100% any goodwill impairment that has been recognized during the period.*
- *100% of upstream unrealized profits (losses) that are included in subsidiary's income.*
- *100% of any upstream profit (losses) that were realized in a PP, but have become realized during the CP.*

Goodwill Impairment = Goodwill will remain as calculated on the acquisition date, unless there are any indications of impairment and an impairment test is required. If the impairment test identifies that the carrying amount of the reporting unit, including goodwill, is in excess of its fair value, the difference is recorded as a goodwill impairment loss in accordance with ASPE 3064.

Non-controlling Interest – Income Statement =

NCI ownership % × Adjusted net income of the subsidiary*

** The required adjustments to the subsidiary income are for:*

- *100% of the amounts charged to income for FV changes realized during the period through use or sale.*
- *If the acquisition date NCI has been recorded at FV (i.e., direct measurement method), 100% any goodwill impairment that has been recognized during the period.*
- *100% of upstream unrealized profits (losses) that are included in subsidiary's income.*
- *100% of any upstream profit (losses) that were realized in a PP, but have become realized during the CP.*

Controlling Interest in Consolidated Net Income =

Consolidated net income − Non-controlling interest in consolidated net income

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