Accounting for investments in a subsidiary in separate financial statements

This article aims to:
Highlight two IFRIC agenda decisions in relation to separate financial statements.
Introduction

Indian Accounting Standard (Ind AS) 27, Separate Financial Statements' prescribes the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. Ind AS 27 defines separate financial statements as those presented by a parent (i.e. an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with Ind AS 109, Financial Instruments. A parent may hold various instruments issued by its subsidiary. If this is the case, then in preparing its separate financial statements, the parent needs to determine whether each instrument:

- Forms part of the 'investment in a subsidiary' and accounted for under Ind AS 27 or
- Is a separate financial instrument that falls in the scope of Ind AS 109.

The assessment of which standard to apply may be straightforward in some cases such as trade receivables or loans receivables from a subsidiary clearly fall under the scope of Ind AS 109. However, in other cases, such as preference shares, the assessment may require judgement because the term 'investment in a subsidiary' is not defined in Ind AS 27.

When an entity holds an initial financial asset accounted for under Ind AS 109 and subsequently obtains control of the investee by acquiring an additional interest, a question arises about how to determine the cost of the investment in the subsidiary. In January 2019, the IFRS Interpretations Committee (IFRIC) published two agenda decisions under International Accounting Standard (IAS) 27, Separate Financial Statements as below:

- Investments in a subsidiary accounted for at cost: Step acquisition
- Investments in a subsidiary accounted for at cost: Partial disposal.

The article discusses the outcome of these IFRIC decisions.

Investment in a subsidiary accounted for at cost: Step acquisition

Background

An entity preparing separate financial statements elects to account for its investments in subsidiaries at cost (as per IAS 27). The entity holds an initial investment in another entity (investee). The investment is an investment in an equity instrument (as per IAS 32, Financial Instruments: Presentation). The investee is not an associate, joint venture or subsidiary of the entity and, accordingly, the entity applies International Financial Reporting Standard (IFRS) 9, Financial Instruments in accounting for its initial investment (initial interest).

The entity subsequently acquires an additional interest in the investee (additional interest), which results in the entity obtaining control of the investee i.e. the investee becomes a subsidiary of the entity.

An issue arose as to how the entity determines the cost of its investment in the subsidiary i.e. as the sum of:

- **Fair value as deemed cost:** The fair value of the initial interest at the date of obtaining control of the subsidiary, plus any consideration paid for the additional interest, or
- **Accumulated cost approach:** The consideration paid for the initial interest (original consideration), plus any consideration paid for the additional interest (accumulated cost approach).

Further, when an entity applies the accumulated cost approach it would need to account for the difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration. However, it is not clear how would an entity account for such a difference.

Determination of cost of investment

IAS 27 does not define 'cost', nor does it specify how an entity determines the cost of an investment acquired in stages. 'Cost' is defined in other standards such as IAS 16, Property, Plant and Equipment, IAS 38, Intangible Assets and IAS 40, Investment Property. The IFRIC noted that an entity may apply one of the following approaches, on a consistent basis to step acquisition transactions, to determine the cost of its investment in the subsidiary:

- **Fair value approach:** Under this approach, an entity determines the cost of its investment in the subsidiary as the sum of the fair value of the initial interest at the date of obtaining control plus any consideration paid for the additional interest making an analogy to IFRS 3, Business Combinations. Any fair value gains or losses recognised in Other Comprehensive Income (OCI) may be transferred to retained earnings or remain in OCI.

---

1. Ind AS 27 is converged with IAS 27, Separate Financial Statements.
• **Accumulated cost approach:** Under this approach, an entity determines the cost of its investment in the subsidiary as the sum of the consideration paid for the initial interest plus any consideration paid for the additional interest. Any difference between the fair value of the initial interest on the date of obtaining control and the consideration paid on the initial investment is recognised in profit or loss regardless of whether, before obtaining control, the entity had presented subsequent changes in fair value of the initial interest in profit or loss or OCI.

An entity may apply either of the above approaches on a consistent basis, when it holds an initial financial asset in an investee accounted for under IFRS 9 and subsequently obtains significant influence or joint control.

**Disclosure requirements**

Applying guidance in IAS 1, *Presentation of Financial Statements*, an entity should also make appropriate disclosures which would assist users of financial statements in understanding how step acquisition transactions are reflected in reporting financial performance and financial position.

**Investment in a subsidiary accounted for at cost: Partial disposal**

In a similar fact pattern, an entity prepares separate financial statements and elects to account for its investments in subsidiaries at cost as per IAS 27. The entity holds an initial investment in a subsidiary (investee). The investment is an investment in an equity instrument as per IAS 32. The entity subsequently disposes off a part of its investment and loses control on the investee. After the disposal, the entity has neither joint control of, nor significant influence over the investee.

**Accounting issue**

An accounting issue arose whether the investment retained (retained interest) is eligible for the presentation election as per IFRS 9 which permits the holder of particular investments in equity instruments to present subsequent changes in fair value in OCI.

Further, an entity would need to present the difference between the cost of the retained interest and its fair value on the date of losing control of the investee. However, it is not clear whether such difference should be presented in the profit or loss or OCI.

**Accounting guidance**

IAS 27 requires an entity preparing separate financial statements to apply all applicable IFRS except when accounting for investments in subsidiaries, associates, and joint ventures for which IAS 27 provides specific guidance.

In the given case, after the partial disposal transaction, the entity has neither joint control of, nor significant influence over the investee. IFRIC noted that the entity is eligible to apply IFRS 9 for the first time in accounting for retained interest in investee. The presentation election under IFRS 9 applies at the initial recognition of an investment in an equity instrument. An investment in an equity instrument within the scope of IFRS 9 is eligible for the election if it is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies.

**Conclusion**

In the given case, it was concluded that the retained interest is eligible for the presentation election of IFRS 9 and the entity should make this election when it first applies IFRS 9 to the retained interest (i.e. at the date of losing control of the investee). Any difference between the cost of the retained interest and its fair value is recognised in profit or loss regardless of the presentation election under IFRS 9 for subsequent changes in fair value.
Points to consider

IFRIC agenda decisions are viewed as additional guidance that provide new and persuasive information on the application of IFRS.

Entities should account for the resulting changes as a change in accounting policy in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Since Ind AS 27 is converged with IAS 27, entities should analyse the impact of these agenda decisions and implement the resulting changes in a timely manner.

Entities should consider appropriate disclosures as per Ind AS 8 if the accounting policy change resulting from an agenda decision has not been applied in financial statements issued after the publication of an agenda decision.