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MFRS Hot Topics

Consolidated financial statements when an entity ceases to be a parent entity

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Welcome to MFRS Hot Topics - a publication from SJ Grant Thornton. This issue provides guidance on consolidated financial statements when an entity ceases to be a parent entity.

If an entity has been a parent entity during an annual reporting period, but is no longer a parent at the end of the reporting period (period-end), is it required to prepare consolidated financial statements?

This Hot Topics will provide analysis of this practical issue, with references made to MFRS 10 Consolidated Financial Statements, MFRS 127 Separate Financial Statements and MFRS 128 Investments in Associates and Joint Ventures.

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Guidance

In our view consolidated financial statements should be prepared if the reporting entity has been a parent entity at any time during the reporting period (unless it is exempted from so doing in accordance with MFRS 10.4). An entity that has disposed of its last or only subsidiary prior to period-end should therefore prepare consolidated financial statements that include those subsidiaries' results and cash flows up to the date control was lost.

Our view

MFRS 10 does not directly address whether consolidated financial statements should be presented by an entity that has been a parent entity during an annual period but has no subsidiaries at the period-end. In the absence of specific guidance, questions have arisen as to whether consolidated financial statements are required in this situation. Although the view taken will not affect the statement of financial position (statement of financial position) at the period-end, it will have a significant effect on the reported results and cash flows and also on comparative information.

Our view is that consolidated financial statements are needed if an entity has been a parent entity at any time during the reporting period (a reporting period view). This view is supported by a number of observations:

- MFRS 10.B88 states in part, "An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary…".
- MFRS 10 does not contain a scope exemption for an entity that disposes of its last subsidiary during the period.
- although it might be argued that MFRS 10 is ambiguous in this respect, IFRS in general considers transactions and events over the course of the reporting period, not only the position at period-end.
- if (for example) an entity that was a parent at the end of the previous reporting period and has since disposed of its subsidiaries does not present consolidated financial statements for the current period, the effect would be that:
  - it never reports the results of losing control of its last subsidiary(ies) as required by MFRS 10.25-26.
  - it would need to restate comparative information in order for it to be comparable. It is not clear that IFRS provides any basis for restating comparatives in these circumstances given that there is no change of accounting policy.
- if the view is taken that MFRS 10's references to a parent entity relate only to an entity that meets the definition of a parent at period-end, there is no guidance on how to account for investments in subsidiaries that were held during the period. IAS 27's requirements on separate financial statements apply only to:
  - accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by local regulations, to present financial statement (IAS 27.2).
  - parent entities that are exempted from consolidation in accordance with MFRS 10.4.

Investments in associates and joint ventures

An investor may have held an investment in an associate during the reporting period but have disposed of it by the period-end. MFRS 128 Investments in Associates and Joint Ventures requires that investments in associates and joint ventures are accounted for in accordance with the equity method with limited exceptions. The exemptions include if the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in MFRS 10.4(a) or if the criteria in MFRS 128.17(a)-(d) apply (MFRS 128.17). When an entity prepares separate financial statements, it shall apply MFRS 127.

MFRS 128.22-24 are explicit that equity accounting continues until the entity's investment ceases to be an associate or a joint venture. Accordingly, there is no ambiguity as to how to account for an investment in an associate or joint venture that has been disposed of by the period-end and no basis for changing the previous accounting post-disposal.

Where a parent entity investor also prepares separate financial statements, MFRS 128.44 requires that an investment in an associate or a joint venture be accounted for in the entity's separate financial statements in accordance with MFRS 127.10 (ie at cost or in accordance with MFRS 139).

If you have further enquiries, do not hesitate to contact your usual point of contact at our offices.

KUALA LUMPUR

Level 11, Sheraton Imperial Court
Jalan Sultan Ismail
50774 Kuala Lumpur

T +603 2692 4022
F +603 2721 5229
E info@my.gt.com

PENANG

51-8-A,
Menara BHL Bank
Jalan Sultan Ahmad Shah
10500 Penang

T +604 228 7828
F +604 227 9828
E info.pg@my.gt.com

KUANTAN

A-105A, 1st Floor
Sri Dagangan, Jalan Tun Ismail
25000 Kuantan
Pahang

T +609 515 6124
F +609 515 6126
E info.ktn@my.gt.com

JOHOR BAHRU

Unit 29-08, Level 29
Menara Landmark
12 Jalan Ngee Heng
80000 Johor Bahru, Johor

T +607 223 1848
F +607 224 9848
E info.jb@my.gt.com

www.gt.com.my