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ACCOUNTING STANDARDS BOARD JULY 1992 FRS 2**SUMMARY**

- a** Financial Reporting Standard No 2 - 'Accounting for Subsidiary Undertakings' (the FRS) sets out the conditions under which an undertaking that is the parent undertaking of other undertakings (its subsidiary undertakings) should prepare consolidated financial statements. The FRS also sets out the manner in which consolidated financial statements are to be prepared. The purpose of consolidated financial statements is to provide financial information about the economic activities of a group. The Companies Act 1985, as amended by the Companies Act 1989, (the amended Act is referred to as 'the Act') defines a parent undertaking and its subsidiary undertakings that together make up a group. The FRS adopts these definitions.
- b** The FRS supersedes Statement of Standard Accounting Practice No 14 'Group accounts' and the Board's 'Interim Statement: Consolidated Accounts', except for the following paragraphs of the Interim Statement: paragraphs 32 and 33, A9 and A10, on joint ventures and paragraphs 38, A13 - A18 and A23 dealing with the amendments to SSAP I 'Accounting for associated companies'.
- c** The FRS applies to all parent undertakings. A parent undertaking that does not report under the Act should comply with the requirements of the FRS except to the extent that these are not permitted by any statutory framework under which the undertaking reports.
- d** A parent undertaking should prepare consolidated financial statements for its group in accordance with the standard accounting practice set out in the FRS unless it uses one of the exemptions permitted by the Act and set out in paragraph 21 of the FRS.
- e** The Act and the FRS exempt a parent undertaking from preparing consolidated financial statements if:
 - i** its group is small or medium-sized and not an ineligible group as defined in section 248; or
 - ii** it is a wholly-owned or majority-owned subsidiary undertaking and its immediate parent undertaking is established under the law of a member state of the European Community. Exemption is conditional on compliance with certain further conditions in section 228; or
 - iii** all of its subsidiary undertakings are permitted or required to be excluded from consolidation by section 229.
- f** The consolidated financial statements should be prepared by consolidating financial information for the parent undertaking and all its subsidiary undertakings, except for any subsidiary undertakings that are to be excluded from consolidation by virtue of the requirements of the Act and the FRS.
- g** A subsidiary undertaking is to be excluded from consolidation if:
 - i** severe long-term restrictions substantially hinder the exercise of the parent undertaking's rights over the subsidiary undertaking's assets or management; or
 - ii** the group's interest in the subsidiary undertaking is held exclusively with a view to subsequent resale and the subsidiary undertaking has not previously been consolidated; or
 - iii** the subsidiary undertaking's activities are so different from those of other undertakings to be included in the consolidation that its inclusion would be incompatible with the obligation to give a true and fair view.

The Act permits rather than requires exclusion in cases (i) and (ii) above. The FRS requires exclusion in these circumstances because the same conditions that justify permitting exclusion also make consolidation inappropriate. In addition, the FRS requires the circumstances in which subsidiary undertakings are to be excluded from consolidation to be interpreted strictly. It is important that only those subsidiary undertakings whose consolidation would be inappropriate are excluded from consolidation so that consolidated financial statements reflect in full the resources, obligations and results of the group.

- h** The FRS requires additional disclosures for subsidiary undertakings excluded from consolidation and

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requires them to be accounted for as follows.

- i** Subsidiary undertakings excluded from consolidation because of severe long-term restrictions are to be treated as fixed asset investments. They are to be included at their carrying amount when the restrictions came into force, subject to any write down for permanent diminution in value, and no further accruals are to be made for profits or losses of those subsidiary undertakings, unless the parent undertaking still exercises significant influence. In the latter case they are to be treated as associated undertakings.
- ii** Subsidiary undertakings excluded from consolidation because they are held exclusively for resale and have not previously been consolidated are to be included as current assets at the lower of cost and net realisable value.
- iii** Subsidiary undertakings excluded from consolidation because of their different activities are to be accounted for using the equity method as required by the Act.
- i** Minority interests in total should be reported separately in the consolidated balance sheet and profit and loss account. When an entity becomes a subsidiary undertaking the assets and liabilities attributable to its minority interest should be included on the same basis as those attributable to the interest held by the parent and other subsidiary undertakings. The effect of this for an acquisition is that all the subsidiary undertaking's identifiable assets and liabilities are included at fair value as required by the Act. No goodwill should be attributed to the minority interest.
- j** Intra-group transactions may result in profits or losses being included in the book value of assets to be included in the consolidation; the FRS requires the elimination in full of any such profits or losses because, for the group as a whole, no profits or losses have arisen.
- k** Uniform group accounting policies should generally be used in preparing the consolidated financial statements; in exceptional cases different policies may be used with disclosure.
- l** The financial statements of all subsidiary undertakings to be used in preparing consolidated financial statements should have the same financial year end and be for the same accounting period as those of the parent undertaking of the group. Where the financial year of a subsidiary undertaking differs from that of the parent undertaking of the group, interim financial statements for that subsidiary undertaking prepared to the parent undertaking's accounting date should be used. If this is impracticable, earlier financial statements of the subsidiary undertaking may be used, provided they are prepared for a financial year that ended not more than three months earlier.
- m** Changes in membership of a group occur on the date control passes, whether by a transaction or other event. Changes in the membership of the group during the period should be disclosed.
- n** When a subsidiary undertaking is acquired the FRS requires its identifiable assets and liabilities to be brought into the consolidation at their fair values at the date that undertaking becomes a subsidiary undertaking, even if the acquisition has been made in stages. When a group increases its interest in an undertaking that is already its subsidiary undertaking, the identifiable assets and liabilities of that subsidiary undertaking should be revalued to fair value and goodwill arising on the increase in interest should be calculated by reference to that fair value. This revaluation is not required if the difference between fair values and carrying amounts of the identifiable assets and liabilities attributable to the increase in stake is not material.
- o** The effect of consolidating the parent and its subsidiary undertakings may be that aggregation obscures useful information about the different undertakings and activities included in the consolidated financial statements. Parent undertakings are encouraged to give segmental analysis to provide readers of consolidated financial statements with useful information on the different risks and rewards, growth and prospects of the different parts of the group. The specification of such analysis, however, falls outside the scope of the FRS.
- p** The accounting practices set out in the FRS should be adopted as soon as possible and regarded as standard for periods ending on or after 23 December 1992, except for Republic of Ireland companies, who should regard it as standard after the date of application of the Irish legislation implementing the

European Community Seventh Directive. Such Irish companies should adopt the accounting practices in the FRS as soon as possible after the enactment of the implementing legislation.

OBJECTIVE

- 1 The objective of this FRS is to require parent undertakings to provide financial information about the economic activities of their groups by preparing consolidated financial statements.* These statements are intended to present financial information about a parent undertaking and its subsidiary undertakings as a single economic entity to show the economic resources controlled by the group, the obligations of the group and the results the group achieves with its resources.**

* 'financial statements' is the term used in the FRS to mean the same as the term 'accounts' used in the Companies Acts.

** The Companies Act 1985, as amended by the 1989 Act, contains detailed provisions relating to consolidated financial statements. The FRS considers the application of the Act and adds to its provisions where necessary.

DEFINITIONS

The following definitions apply for the purposes of the FRS and in particular the statement of standard accounting practice set out in paragraphs 18 to 56.

The terms defined below which are also defined in the Act have the same meaning in the FRS as in the Act, notwithstanding that in some cases the FRS definition is a summary or explanation rather than a repetition of the definition in the Act. The definitions should therefore be interpreted by reference to the full provisions of the Act. The marginal notes give the main references in the Act. References to sections and schedules are to those of the Act unless otherwise stated.

- 2 *The Act :-*
Companies Act 1985 as amended by the Companies Act 1989.
- 3 *Companies (Northern Ireland) Order 1986:-*
Companies (Northern Ireland) Order 1986 as amended by the Companies (Northern Ireland) Order 1990 and the Companies (No 2) (Northern Ireland) Order 1990.
- 4 *Consolidated financial statements:-*
The financial statements of a group prepared by consolidation.
- 5 *Consolidation:-*
The process of adjusting and combining financial information from the individual financial statements of a parent undertaking and its subsidiary undertakings to prepare consolidated financial statements that present financial information for the group as a single economic entity.
- 6 *Control:-*
The ability of an undertaking to direct the financial and operating policies of another undertaking with a view to gaining economic benefits from its activities.
- 7 *Dominant influence:*
Influence that can be exercised to achieve the operating and financial policies desired by the holder of the influence, notwithstanding the rights or influence of any other party.
 - a In the context of paragraph 14(C) and section 258(2)(C) *the right to exercise a dominant influence* means that the holder has a right to give directions with respect to the operating and financial policies of another undertaking with which its directors are obliged to comply, whether or not they are for the benefit of that undertaking. *[From 10ASch4(1)]*
 - b *The actual exercise of dominant influence* is the exercise of an influence that achieves the result that the operating and financial policies of the undertaking influenced are set in accordance with the wishes of the holder of the influence and for the holder's benefit whether or not those wishes are explicit. The actual exercise of dominant influence is identified by its effect in practice rather than by the way in which it is exercised. *[FRS defining phrase used in s258(4)(a)]*
- 8 *Equity method:-*
A method of accounting for an investment that brings into the consolidated profit and loss account the investor's share of the investment undertaking's results and that records the investment in the consolidated balance sheet at the

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investor's share of the investment undertaking's net assets including any goodwill arising to the extent that it has not previously been written off.

- 9 **Group:-**
A parent undertaking and its subsidiary undertakings. [From s262]

- 10 **Interest held on a long-term basis:-**
An interest which is held other than *exclusively with a view to subsequent resale*. [FRS defining phrase used in s260]

- 11 **Interest held exclusively with a view to subsequent resale:-** [FRS defining phrase used in s229(3)(c)]
 - a An interest for which a purchaser has been identified or is being sought, and which is reasonably expected to be disposed of within approximately one year of its date of acquisition; or
 - b an interest that was acquired as a result of the enforcement of a security, unless the interest has become part of the continuing activities of the group or the holder acts as if it intends the interest to become so.

- 12 **Managed on a unified basis:-** [FRS defining phrase used in s258(4)(b)]
Two or more undertakings are managed on a unified basis if the whole of the operations of the undertakings are integrated and they are managed as a single unit. Unified management does not arise solely because one undertaking manages another.

- 13 **Minority interest in a subsidiary undertaking:-** [From 4ASch 17]
The interest in a subsidiary undertaking included in the consolidation that is attributable to the shares held by or on behalf of persons other than the parent undertaking and its subsidiary undertakings.

- 14 **Parent undertaking and subsidiary undertaking:-** [From s258 and 10ASch]
An undertaking is the parent undertaking of another undertaking (a subsidiary undertaking) if any of the following apply.
 - a It holds a majority of the voting rights in the undertaking. [From s258(2)(a)]
 - b It is a member of the undertaking and has the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters. [From s258(2)(b) and 10ASch 3]
 - c It has the right to exercise a dominant influence over the undertaking: [From s258(2)(c) and 10ASch 4]
 - i by virtue of provisions contained in the undertaking's memorandum or articles; or
 - ii by virtue of a control contract. The control contract must be in writing and be of a kind authorised by the memorandum or articles of the controlled undertaking. It must also be permitted by the law under which that undertaking is established. [From 10ASch4(2)]
 - d It is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking. [From s258(2)(d)]
 - e It has a participating interest in the undertaking and: [From s258(4)]
 - i it actually exercises a dominant influence over the undertaking; or

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- ii it and the undertaking are managed on a unified basis.

- f A parent undertaking is also treated as the parent undertaking of the subsidiary undertakings of its subsidiary undertakings. [From s258(5)]

For the purpose of section 258 [parent and subsidiary undertakings] an undertaking shall be treated as a member of another undertaking: [From s258(3)]

- i if any of its subsidiary undertakings is a member of that undertaking; or
- ii if any shares in that other undertaking are held by a person acting on behalf of the parent undertaking or any of its subsidiary undertakings.

Any shares held, or powers exercisable, by a subsidiary undertaking should be treated as held or exercisable by its parent undertaking. [From 10ASch9]

15 *Participating interest :-* [From s260]

An interest held by an undertaking in the shares of another undertaking which it holds on a long-term basis for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest.

- a A holding of 20% or more of the shares of an undertaking shall be presumed to be a participating interest unless the contrary is shown.
- b An interest in shares includes an interest which is convertible into an interest in shares, and includes an option to acquire shares or any interest which is convertible into shares.
- c An interest held on behalf of an undertaking shall be treated as held by that undertaking.

16 *Undertaking:-* [From s259]

A body corporate, a partnership or an unincorporated association carrying on a trade or business with or without a view to profit.

17 *Voting rights in an undertaking:-* [From 10ASch2(1)]

Rights conferred on shareholders in respect of their shares or, in the case of an undertaking not having a share capital, on members, to vote at general meetings of the undertaking on all, or substantially all, matters. Schedule 10A deals with the attribution of voting rights in certain circumstances.

STATEMENT OF STANDARD ACCOUNTING PRACTICE

The statement of standard accounting practice set out in paragraphs 18 to 56 of the FRS should be read in the context of the Objective of the FRS as stated in paragraph 1, the definitions set out in paragraphs 2 to 17 and also of the Foreword to Accounting Standards and the Statement of Principles for Financial Reporting currently in issue.

In the statement of standard accounting practice marginal notes give the main references to the Act. If no marginal reference is given the requirement is that of the FRS alone. The statement of standard accounting practice should be interpreted by reference to the full provisions of the Act notwithstanding that the statement summarises certain provisions of the Act. References to sections and schedules are to those of the Act unless otherwise stated.

The Explanation section of the FRS, set out in paragraphs 59 to 94, shall be regarded as part of the statement of standard accounting practice insofar as it assists in interpreting that statement.

Scope

- 18** This standard applies to all parent undertakings that prepare the financial statements described below, whether or not they report under the Act. Parent undertakings that prepare consolidated financial statements intended to give a true and fair view of the financial position and profit or loss (or income and expenditure) of their group should prepare such statements in accordance with the requirements of the FRS. A parent undertaking that uses one of the exemptions from preparing consolidated financial statements (described in paragraph 21) but prepares individual financial statements intended to give a true and fair view of its own financial position and profit or loss (or income and expenditure) should include the statement required by paragraph 22. The FRS does not otherwise deal with the individual financial statements of a parent undertaking.
- 19** Parent undertakings that do not report under the Act should comply with the requirements of the FRS, and of the Act where referred to in the FRS, except to the extent that these requirements are not permitted by any statutory framework under which such undertakings report .

Consolidated financial statements**Preparation of consolidated financial statements**

- 20** A parent undertaking should prepare consolidated financial statements for its group unless it uses one of the exemptions set out in paragraph 21. [s227, s228 and s248]

Exempt parent undertakings

- 21** A parent undertaking is exempt from preparing consolidated financial statements for its group on any one of the following grounds.
- a** The group is small or medium-sized and is not an ineligible group as defined in section 248. A group is ineligible if any of its members is a public company, a banking institution, an insurance [s248]

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company or an authorised person under the Financial Services Act 1986.

- b** The parent undertaking is a wholly-owned subsidiary undertaking and its immediate parent undertaking is established under the law of a member state of the European Community. Exemption is conditional on compliance with certain further conditions set out in section 228(2). A parent undertaking is not exempt if any of its securities is listed on a stock exchange in any European Community country. [s228]
- c** The parent undertaking is a majority-owned subsidiary undertaking and meets all the conditions for exemption as a wholly-owned subsidiary undertaking set out in section 228(2) as well as the additional conditions set out in section 228(1)(b). [s228]
- d** All of the parent undertaking's subsidiary undertakings are permitted or required to be excluded from consolidation by section 229. (The conditions for exclusion of section 229 are more fully described in paragraph 2s and are elaborated on in paragraphs 76 to 78.) [s229(5)]
- 22** The Act sets out disclosure requirements for parent companies not required to prepare consolidated financial statements. In addition to providing this information, a parent undertaking making use of an exemption from preparing consolidated financial statements should state that its financial statements present information about it as an individual undertaking and not about its group. This statement should include or refer to a note giving the grounds on which the parent undertaking is exempt from preparing consolidated financial statements, as required by Schedule 5 paragraph I(4). [s231 and 5 Sch Part 1]

Undertakings to be included in the consolidation
- 23** As required by the Act, the consolidated financial statements should include the parent undertaking and all its subsidiary undertakings, except those that are required to be excluded under the conditions set out in paragraph 25 below. [s229(1)]

Disproportionate expense and undue delay
- 24** Neither disproportionate expense nor undue delay in obtaining the information necessary for the preparation of consolidated financial statements can justify excluding from consolidation subsidiary undertakings that are individually or collectively material in the context of the group. [FRS allows s229(3)(b) exclusion only where the undertaking is not material]

Subsidiary undertakings to be excluded from consolidation
- 25** The exclusions required by this paragraph are based on the exclusions permitted or required by section 229 (3) and (4). A subsidiary undertaking should be excluded from consolidation where: [s229(3) and (4)]

 - a** severe long-term restrictions substantially hinder the exercise of the rights of the parent undertaking over the assets or management of the subsidiary undertaking. The rights referred to are those by reason of which the parent undertaking is defined as such under section 258 and in the absence of which it would not be the parent undertaking; or [FRS requires exclusion permitted by s229(3)(a)]
 - b** the interest in the subsidiary undertaking is held exclusively with a view to subsequent resale (as defined in paragraph II) and the subsidiary undertaking has not previously been consolidated in group accounts prepared by the parent undertaking; or [FRS requires exclusion permitted by s229(3)(c)]
 - c** the subsidiary undertaking's activities are so different from those of [s229(4)]

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other undertakings to be included in the consolidation that its inclusion would be incompatible with the obligation to give a true and fair view. It is exceptional for such circumstances to arise and it is not possible to identify any particular contrast of activities where the necessary incompatibility with the true and fair view generally occurs. The Act provides that exclusion on the grounds of different activities does not apply 'merely because some of the undertakings are industrial, some commercial and some provide services, or because they carry on industrial or commercial activities involving different products or provide different services'.

- 26 As required by the Act, subject to the conditions and exemptions of section 231, the names of any subsidiary undertakings excluded from the consolidation and the reasons why they have been excluded should be given. [s231 and 5Sch15(4)]

Accounting for excluded subsidiary undertakings

Severe long-term restrictions

- 27 A subsidiary undertaking excluded on the grounds set out in paragraph 2s(a) [severe long-term restrictions] should be treated as a fixed asset investment. If restrictions were in force at its acquisition date, the subsidiary undertaking should be carried initially at cost if restrictions came into force at a later date, the subsidiary undertaking should be carried at a fixed amount calculated using the equity method at that date. While the restrictions are in force, no further accruals should be made for the profits or losses of that subsidiary undertaking, unless the parent undertaking still exercises a significant influence over it. If this is the case, it should treat the subsidiary undertaking as an associated undertaking using the equity method. The carrying amount of subsidiary undertakings subject to severe long-term restrictions should be reviewed and written down for any permanent diminution in value. In assessing diminution in value, each subsidiary undertaking should be considered individually. Any intra-group amounts due from subsidiary undertakings excluded on the grounds of severe long-term restrictions should also be reviewed and written down, if necessary.
- 28 When the severe restrictions cease and the parent undertaking's rights are restored, the amount of the unrecognised profit or loss that accrued during the period of restriction for that subsidiary undertaking should be separately disclosed in the consolidated profit and loss account of the period in which control is resumed. Similarly, any amount previously charged for permanent diminution that needs to be written back as a result of restrictions ceasing should be separately disclosed.

Held exclusively with a view to subsequent resale

- 29 A subsidiary undertaking that is excluded from consolidation on the grounds set out in paragraph 2s(b) [held exclusively with a view to subsequent resale] should be recorded in the consolidated financial statements as a current asset at the lower of cost and net realisable value.

Different activities

- 30 A subsidiary undertaking excluded on the grounds set out in paragraph 2s(c) [different activities] should be recorded in the consolidated financial statements using the equity method, as required by the Act. [4ASch18]

Disclosures for subsidiary undertakings excluded from consolidation

- 31 In addition to the disclosures required by Schedule 5, subject to section 231, the following information should be given in the consolidated financial [s231 and 5Sch 15-20]

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statements for subsidiary undertakings not included in the consolidation:

- a** particulars of the balances between the excluded subsidiary undertakings and the rest of the group;
 - b** the nature and extent of transactions of the excluded subsidiary undertakings with the rest of the group;
 - c** for an excluded subsidiary undertaking carried other than by the equity method, any amounts included in the consolidated financial statements in respect of:
 - i** dividends received and receivable from that undertaking; and
 - ii** any write-down in the period in respect of the investment in that undertaking or amounts due from that undertaking;
 - d** for subsidiary undertakings excluded because of different activities, the separate financial statements of those undertakings. Summarised information may be provided for undertakings that individually, or in combination with those with similar operations, do not account for more than 20% of any one or more of operating profits, turnover or net assets of the group. The group amounts should be measured by including all excluded subsidiary undertakings.
- 32** Disclosures for excluded subsidiary undertakings in general apply to individual excluded subsidiary undertakings. However, if the information about excluded subsidiary undertakings is more appropriately presented for a sub-unit of the group comprising more than one excluded subsidiary undertaking, the disclosures may be made on an aggregate basis. Any individual sub-unit for these disclosures is to include only subsidiary undertakings excluded under the same sub-section of section 229. Individual disclosures should be made for any excluded subsidiary undertaking, including its subgroup where relevant, that alone accounts for more than 20% of any one or more of operating profits, turnover or net assets of the group. The group amounts should be measured by including all excluded subsidiary undertakings.

Disclosures for principal subsidiary undertakings

- 33** In addition to the disclosures required by Schedule 5, and, like those, subject to the exemptions and conditions of section 231, the following should be shown for each subsidiary undertaking whose results or financial position principally affects the figures in the consolidated financial statements:
- a** the proportion of voting rights held by the parent and its subsidiary undertakings; and
 - b** an indication of the nature of its business.

[s231 and 5 Sch
Part II]

Disclosure of the basis of dominant influence

- 34** Where an undertaking is a subsidiary undertaking only because its parent undertaking has a participating interest in it and actually exercises a dominant influence over it, the consolidated financial statements should disclose the basis of the parent undertaking's dominant influence in addition to the disclosures required, subject to section 231, by Schedule 5 paragraph 15(5).

[s231 and 5 Sch
15(5)]

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Minority interests

- 35 The consolidated balance sheet should show separately the aggregate of the capital and reserves attributable to minority interests at the end of the period under 'Minority interests' in accordance with Schedule 4A paragraph 17(2). This amount represents the aggregate share of net assets or liabilities of subsidiary undertakings included in the consolidation that are attributable to the minority interests. [4A Sch 17(2)]
- 36 The consolidated profit and loss account should show separately the aggregate of profit or loss on ordinary activities for the period attributable to the minority interests under 'Minority interests' in accordance with Schedule 4A paragraph 17(3). Any extraordinary profit or loss attributable to minority interests should be shown separately in accordance with Schedule 4A paragraph 17(4). [4A Sch 17(3) and (4)]
- 37 Profits or losses arising in a subsidiary undertaking should be apportioned between the controlling and minority interests in proportion to their respective interests held over the period in which the profits or losses arose. Where the losses in a subsidiary undertaking attributable to the minority interest result in its interest being one in net liabilities rather than net assets, the group should make provision to the extent that it has any commercial or legal obligation (whether formal or implied) to provide finance that may not be recoverable in respect of the accumulated losses attributable to the minority interest.
- 38 Whether the assets and liabilities of a subsidiary undertaking are included at fair values or adjusted carrying amounts*, those attributable to the minority interest should be included on the same basis as those attributable to the interests held by the parent and its other subsidiary undertakings. However, goodwill arising on acquisition should only be recognised with respect to the part of the subsidiary undertaking that is attributable to the interest held by the parent and its other subsidiary undertakings. No goodwill should be attributed to the minority interest.

* Where the acquisition method of accounting is to be used in consolidating a subsidiary undertaking, Schedule 4A paragraph 9 requires the identifiable assets and liabilities of the undertaking acquired to be included in the consolidation at their fair values as at the date of acquisition.

Where the merger method of accounting is to be used, Schedule 4A paragraph 11 requires the assets and liabilities of the subsidiary undertaking to be consolidated at the amounts at which they stand in that undertaking's financial statements, subject to any adjustments authorised or required by the Act.

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*Consolidation adjustments**Intra-group transactions*

- 39 To the extent that they are reflected in the book value of assets to be included in the consolidation, profits or losses on any intra-group transactions should be eliminated in full. Amounts in relation to debts and claims between undertakings included in the consolidation should also be eliminated. The elimination of profits or losses relating to intra-group transactions should be set against the interests held by the group and the minority interest in respective proportion to their holdings in the undertaking whose individual financial statements recorded the eliminated profits or losses. All profits or losses on transactions that would be eliminated if they were between undertakings included in the consolidation should also be eliminated if one party is a subsidiary undertaking excluded because of its different activities (paragraph 25(c)).

[FRS requirement in relation to 4A Sch6. The Act allows partial elimination but the FRS requires elimination in full]

Accounting policies

- 40 Subject to paragraph 41 below, uniform group accounting policies should be used for determining the amounts to be included in the consolidated financial statements, if necessary by adjusting for consolidation the amounts which have been reported by subsidiary undertakings in their individual financial statements.
- 41 In exceptional cases, different accounting policies may be used. Where the directors of the parent undertaking depart from the Act's general requirement to use the same group accounting rules to value or otherwise determine the assets and liabilities to be included in the consolidated financial statements, Schedule 4A paragraph 3(2) requires disclosure of the particulars, which should include the different accounting policies used.

[4A Sch 3(1)]

[4A Sch 3(2)]

Accounting periods and dates

- 42 The financial statements of all subsidiary undertakings to be used in preparing the consolidated financial statements should, wherever practicable, be prepared to the same financial year end and for the same accounting period as those of the parent undertaking of the group.
- 43 Where the financial year of a subsidiary undertaking differs from that of the parent undertaking of the group, interim financial statements should be prepared to the same date as those of the parent undertaking of the group for use in the preparation of the consolidated financial statements. If it is not practicable to use such interim financial statements, the financial statements of the subsidiary undertaking for its last financial year should be used, providing that year ended not more than three months before the relevant year end of the parent undertaking of the group. In this case any changes that have taken place in the intervening period that materially affect the view given by the group's financial statements should be taken into account by adjustments in the preparation of the consolidated financial statements.
- 44 The following information should be given for each subsidiary undertaking which is included in the consolidated financial statements on the basis of information prepared to a different date or for a different accounting period from that of the parent undertaking of the group:
- a the name of the subsidiary undertaking;
 - b the accounting date or period of the subsidiary undertaking; and
 - c the reason for using a different accounting date or period for the subsidiary undertaking.

[FRS preference of alternatives permitted by 4A Sch 2(2)]

[Subject to s231, 5 Sch 19 requires disclosures for different financial year ends]

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*Changes in composition of a group**Date of changes in group membership*

- 45 The date for accounting for an undertaking becoming a subsidiary undertaking is the date on which control of that undertaking passes to its new parent undertaking. This date is the date of acquisition for Schedule 4A paragraph g or the date of merger. The date for accounting for an undertaking ceasing to be a subsidiary undertaking is the date on which its former parent undertaking relinquishes its control over that undertaking.

Ceasing to be a subsidiary undertaking

- 46 When an undertaking ceases to be a subsidiary undertaking during a period, the consolidated financial statements for that period should include the results of that subsidiary undertaking up to the date that it ceases to be a subsidiary undertaking and any gain or loss arising on that cessation, to the extent that these have not been already provided for in the consolidated financial statements.
- 47 The gain or loss directly arising for the group on an undertaking ceasing to be its subsidiary undertaking is calculated by comparing the carrying amount of the net assets of that subsidiary undertaking attributable to the group's interest before the cessation with any remaining carrying amount attributable to the group's interest after the cessation together with any proceeds received. The net assets compared should include any related goodwill that has not previously been either written off through the profit and loss account or attributed to prior period amortisation or impairment on applying paragraph 70 of FRS 10 'Goodwill and Intangible Assets'. This calculation of gain or loss applies whether the cause of the undertaking ceasing to be a subsidiary undertaking is a direct disposal, a deemed disposal or other event.

- 48 In addition to the disclosures required by Schedule 4A paragraph 15, the consolidated financial statements should give the name of any material undertaking that has ceased to be a subsidiary undertaking in the period, showing any ownership interest retained. Where any material undertaking has ceased to be a subsidiary undertaking other than by the disposal of at least part of the interest held by the group, the circumstances should be explained.

[4A Sch 15]

Becoming or ceasing to be a subsidiary undertaking other than by a purchase or exchange of shares

- 49 Where an undertaking has become or ceased to be a subsidiary undertaking other than as a result of a purchase or exchange of shares, the circumstances should be explained in a note to the consolidated financial statements.

*Changes in stake**Acquiring a subsidiary undertaking in stages*

- 50 Schedule 4A paragraph 9 requires that the identifiable assets and liabilities of a subsidiary undertaking be included in the consolidation at fair value at the date of its acquisition, that is, the date it becomes a subsidiary undertaking. This requirement is also applicable where the group's interest in the undertaking that becomes a subsidiary undertaking is acquired in stages.

[4A Sch 9]

Increasing an interest held in a subsidiary undertaking

- 51 When a group increases its interest in an undertaking that is already its subsidiary undertaking, the identifiable assets and liabilities of that subsidiary undertaking should be revalued to fair value and goodwill arising on the increase in interest should be calculated by reference to those fair values. This

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revaluation is not required if the difference between net fair values and carrying amounts of the assets and liabilities attributable to the increase in stake is not material.

Reducing an interest held in a subsidiary undertaking

- 52 Where a group reduces its interest in a subsidiary undertaking, it should record any profit or loss arising calculated as the difference between the carrying amount of the net assets of that subsidiary undertaking attributable to the group's interest before the reduction and the carrying amount attributable to the group's interest after the reduction together with any proceeds received. The net assets compared should include any related goodwill not previously written off through the profit and loss account. Where the undertaking remains a subsidiary undertaking after the disposal, the minority interest in that subsidiary undertaking should be increased by the carrying amount of the net identifiable assets that are now attributable to the minority interest because of the decrease in the group's interest. No amount for goodwill that arose on acquisition of the group's interest in that subsidiary undertaking should be attributed to the minority interest.

*Distributions**Restrictions on distribution*

- 53 Where significant statutory, contractual or exchange control restrictions on distributions by subsidiary undertakings materially limit the parent undertaking's access to distributable profits, the nature and extent of the restrictions should be disclosed.

Tax on the accumulated reserves of overseas subsidiary undertakings

- 54 The extent to which deferred tax has been accounted for in respect of future remittances of the accumulated reserves of overseas subsidiary undertakings should be disclosed. Where deferred tax has not been provided in respect of all the accumulated reserves of overseas subsidiary undertakings the reason for not fully providing should be given.

Date from which effective

- 55 The accounting practices set out in this statement should be adopted as soon as possible and regarded as standard in respect of consolidated financial statements relating to periods ending on or after 23 December 1992 except for those companies considered below. The accounting practices in this statement should be adopted by Republic of Ireland companies as soon as possible after the enactment of the Irish legislation implementing the European Community Seventh Directive and regarded as standard in respect of consolidated financial statements for periods specified in the date of application of that legislation.

Withdrawal of SSAP 14 'Group accounts' and 'Interim Statement: Consolidated Accounts'

- 56 The FRS supersedes SSAP 14 'Group accounts' and the references to SSAP 14 in other accounting standards should be treated as follows:
- a SSAP 1:- paragraph 66 - last two sentences referring to SSAP 14 are deleted;
 - b SSAP 6:- paragraph 5 - "as required by SSAP 14 'Group accounts'" deleted;

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- c SSAP 23:- paragraph 1 - line 5 "SSAP 14 Group accounts" replaced by "FRS 2 Accounting for subsidiary undertaking" and last two sentences deleted;
paragraph 16 - "in accordance with the requirements of SSAP I14" deleted;
paragraph 22 - "as required by SSAP 14" deleted.

The FRS also supersedes the 'Interim Statement: Consolidated Accounts' except for paragraphs 32 and 33, A9 and A10 on joint ventures and the amendments to SSAP 1 'Accounting for Associated Companies' contained in paragraph 38 of the Interim Statement and the related commentary A13 - A18 and A23. The paragraphs not superseded remain in force.

Financial Reporting Standard No 2 'Accounting for Subsidiary Undertakings' was adopted by the unanimous vote of the nine members of the Accounting Standards Board.

Members of the Accounting Standards Board

David Tweedie	(Chairman)
Allan Cook	(Technical Director)
Robert Bradfield	
Sir Bryan Carsberg	
Elwyn Eilledge	
Michael Garner	
Donald Main	
Roger Munson	
Graham Stacy	

COMPLIANCE WITH INTERNATIONAL ACCOUNTING STANDARDS

- 57** Compliance with the FRS ensures compliance with International Accounting Standard No 27 - 'Consolidated Financial Statements' (IAS 27) except that IAS 27 does not have an exclusion from consolidation for a subsidiary undertaking based on the grounds that its activities are dissimilar from those of other undertakings to be included in the consolidation. The exclusion for different activities is an exclusion required by statute. As explained in the FRS, this is expected to apply only exceptionally when the inclusion of a subsidiary undertaking would not be compatible with the obligation to give a true and fair view.
- 58** The IASC has issued E45 'Proposed Statement - Business Combinations' which includes proposals to implement its harmonisation programme. E45 proposes as the benchmark treatment that, when an entity becomes a subsidiary undertaking and is not wholly owned, minority interests should be measured at the pre-acquisition carrying amounts of their attributable identifiable assets and liabilities. The FRS requires the minority interests to be measured at their proportion of the amount at which the identifiable assets and liabilities are included in the consolidation; for an acquisition this is fair value at that date. This treatment is proposed by the IASC as an allowed alternative.

EXPLANATION*The purpose of consolidated financial statements*

- 59** For a variety of legal, tax and other reasons undertakings generally choose to conduct their activities not through a single legal entity but through several undertakings under the ultimate control of the parent undertaking of that group. For this reason the financial statements of a parent undertaking by itself do not present a full picture of its economic activities or financial position. Consolidated financial statements are required in order to reflect the extended business unit that conducts activities under the control of the parent undertaking.

The legal background to the FRS

- 60** In the United Kingdom the preparation of consolidated financial statements for companies is governed by the Act and the Companies (Northern Ireland) Order 1986. These implement in their respective jurisdictions the provisions of the European Community Seventh Directive. The FRS is drafted to be consistent with the Act, supplementing it with guidance on its application and additional requirements where necessary. The definitions and statement of standard accounting practice contain marginal notes that give references to the Act where these are relevant. Any differences in the application of the FRS in Northern Ireland are explained in the sections setting out the legal provisions in that jurisdiction (paragraph 97). The application of the FRS in the Republic of Ireland is explained in the section on the legal requirements in the Republic of Ireland (paragraph 98).

Parent undertakings not subject to the Act

- 61** The FRS is drafted in terms derived from the Act but applies to all parent undertakings that prepare financial statements intended to give a true and fair view. A parent undertaking not subject to the Act should comply with the requirements of the FRS, and of the Act where referred to in the FRS, except to the extent that these requirements are not permitted by any statutory framework under which the undertaking reports. By reference to the Act, which in most cases accords with requirements the FRS might otherwise introduce itself in respect of such undertakings, the FRS achieves a single set of requirements relating to the preparation of consolidated financial statements both for companies that report under the Act and for other undertakings.

The relationship between the legal background and accounting principles

- 62** The accounting concept that underlies the presentation of consolidated financial statements for a group as a single economic entity is summarised in the definition of control in paragraph 6. Although the definitions of parent and subsidiary undertakings in the Act are founded mainly on the accounting concept of control, section 258 uses a list of tests rather than relying on control directly to determine which undertakings are parent and subsidiary undertakings. In the main the effect of applying the tests in the Act is the same as using a criterion based directly on the accounting concept of control. However, in some cases the tests of the Act may either fail to identify as a subsidiary undertaking one that is controlled by another undertaking or identify as a subsidiary undertaking one that is not controlled by its parent undertaking. In other cases section 258 may identify more than one undertaking as the parent undertaking of the same subsidiary undertaking. Where more than one undertaking is thereby identified as a parent of one subsidiary undertaking, not more than one of those parents can have control as defined in paragraph 6.
- 63** In practice such apparent differences between the effects of applying the Act and the standard can generally be resolved by taking into account the following factors:
- a** the existence of a quasi subsidiary (paragraph 64); or
 - b** the existence of severe long-term restrictions on the rights of the parent undertaking (paragraph 65); or
 - c** the existence of a joint venture agreement, whether formal or informal (paragraphs 66 and 67).
- 64** Undertakings that are directly or indirectly controlled by another undertaking and are sources of benefit

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to that other, but do not qualify according to the tests in the Act as subsidiary undertakings, are described as 'quasi subsidiaries'. The definition and treatment of quasi subsidiaries are not dealt with in this standard*.

- 65** The Act allows a subsidiary undertaking to be excluded from consolidation if the parent undertaking suffers severe long-term restrictions that substantially hinder the exercise of its rights over the assets or management of the subsidiary undertaking. Paragraph 78(c) discusses severe long-term restrictions further.
- 66** The control that identifies undertakings as parent and subsidiary undertakings should be distinguished from shared control, for example, as in a joint venture. It is the parent undertaking's sole control of its subsidiary undertakings that gives it access to its subsidiary undertakings' resources. The parent undertaking extends its economic activities through its subsidiary undertakings using their assets and liabilities in a similar way to its own. The ability of an undertaking that shares control to direct the operating and financial policies of the undertaking in which control is shared is circumscribed by the need to take account of the wishes of the other parties that share control. An undertaking identified as a parent by section 258 that shares control over its subsidiary undertaking may be suffering from severe long-term restrictions, as discussed in paragraph 78(c), in relation to the undertaking in which it shares control.
- 67** Where the tests of the Act identify more than one undertaking as the parent of one subsidiary undertaking it is likely that they have shared control and, therefore, their interests in the subsidiary undertaking are in effect interests in a joint venture and should be treated accordingly. Alternatively, one or more of the undertakings identified under the Act as a parent undertaking may exercise a non-controlling but significant influence over its subsidiary undertaking, in which case it would be more appropriate to treat that subsidiary undertaking in the same way as an associated undertaking rather than to include it in the consolidation.

Identifying parent and subsidiary undertakings

- 68** Parent and subsidiary undertakings are defined in the FRS by applying the provisions of section 258, which are repeated in an abbreviated form in paragraph 14 of the FRS. In addition, the FRS defines some of the phrases that are used in the Act to define undertakings that are parent or subsidiary undertakings. Paragraphs 69-74 below consider some of the terms used.

Dominant influence

- 69** The Act uses 'dominant influence' as a key phrase in two of the conditions of section 258 that identify parent and subsidiary undertakings.
- 70** Section 258(2)(c) identifies an undertaking as a parent undertaking if it has the right to exercise a dominant influence over another undertaking:
- a** by virtue of provisions contained in the undertaking's memorandum or articles; or
 - b** by virtue of a control contract.

Schedule 10A paragraph 4(I) states that for the purposes of sub-section 258(2)(c) 'an undertaking shall not be regarded as having the right to exercise a dominant influence over another undertaking unless it has a right to give directions with respect to the operating and financial policies of that other undertaking which its directors are obliged to comply with whether or not they are for the benefit of that other undertaking'. This forms the basis of the definition set out in paragraph 7(a) of the FRS. In the United Kingdom directors are bound by a common law duty to act in the best interests of their company. For this reason there may, in some cases, be a risk that accepting a right to exercise dominant influence, as here defined, would be in breach of the above duty.

- 71** In a second reference to dominant influence, section 258(4)(a) identifies an undertaking as the subsidiary undertaking of another (its parent undertaking) if that other has a participating interest in it and actually

* At the time of issue of the FRS, the Board is in the course of developing a separate standard dealing inter alia with quasi subsidiaries.

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exercises a dominant influence over it. Schedule 10A paragraph 4(3) provides that the definition of the 'right to exercise a dominant influence' for the purposes of section 258(2)(c) shall not affect the construction of 'actually exercises a dominant influence' in section 258(4)(a). The FRS defines 'actual exercise of dominant influence', as the exercise of an influence that achieves the result that the operating and financial policies of the undertaking influenced are set in accordance with the wishes of the holder of the influence and for its benefit (whether or not those wishes are explicit).

- 72 As indicated in paragraph 7(b) of the FRS, the actual exercise of dominant influence is identified by its effect in practice rather than the means by which it is exercised. The effect of the exercise of dominant influence is that the undertaking under influence implements the operating and financial policies that the holder of the influence desires. Thus a power of veto or any other reserve power that has the necessary effect in practice can form the basis whereby one undertaking actually exercises a dominant influence over another. However, such powers are likely to lead to the holder actually exercising a dominant influence over an undertaking only if they are held in conjunction with other rights or powers or if they relate to the day-to-day activities of that undertaking and no similar veto is held by other parties unconnected to the holder. The full circumstances of each case should be considered, including the effect of any formal or informal agreements between the undertakings, to decide whether or not one undertaking actually exercises a dominant influence over another. Commercial relationships such as that of supplier, customer or lender do not of themselves constitute dominant influence.
- 73 A parent undertaking may actually exercise its dominant influence in an interventionist or non-interventionist way. For example, a parent undertaking may set directly and in detail the operating and financial policies of its subsidiary undertaking or it may prefer to influence these by setting out in outline the kind of results it wants achieved without being involved regularly or on a day-to-day basis. Because of the variety of ways that dominant influence may be exercised evidence of continuous intervention is not necessary to support the view that dominant influence is actually exercised. Sufficient evidence might be provided by a rare intervention on a critical matter. Once there has been evidence that one undertaking has exercised a dominant influence over another, then the dominant undertaking should be assumed to continue to exercise its influence until there is evidence to the contrary. However, it is still necessary for the preparation of the consolidated financial statements to examine the relationship between the undertakings each year to assess any evidence of change in status that may have arisen.

Managed on a unified basis

- 74 Section 258(4)(b) identifies an undertaking as a parent undertaking of another undertaking (its subsidiary undertaking) if it has a participating interest in that other undertaking and they are managed on a unified basis. Undertakings are managed on a unified basis if the whole of the operations of the undertakings are integrated and they are managed as a single unit. Unified management does not arise solely because one undertaking manages another because this may not fulfil the condition that the operations of the undertakings are integrated.

Preparation of consolidated financial statements

- 75 The requirements of the FRS apply to all parent undertakings that prepare consolidated financial statements intended to give a true and fair view of the financial position and profit or loss of the group. In giving such a view the same accounting principles apply in general to consolidated financial statements as would apply to the financial statements of a single entity. Parent undertakings should comply with the requirements of the FRS in preparing consolidated financial statements giving a true and fair view, even if the parent undertaking is not specifically required to prepare consolidated financial statements.

Exclusion of subsidiary undertakings from consolidation

- 76 The Act requires that all the subsidiary undertakings of a parent undertaking are to be included in the consolidated financial statements for that group, subject to the exceptions permitted or required by section 229(2)-(4). The circumstances in which the Act permits or requires a subsidiary undertaking to be excluded from consolidation are the following:

Permissive exclusions

- a 'if its inclusion is not material for the purpose of giving a true and fair view; but two or more

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undertakings may be excluded only if they are not material taken together'; or

- b** 'where the information necessary for the preparation of group accounts cannot be obtained without disproportionate expense or undue delay'; or
- c** 'where severe long-term restrictions substantially hinder the exercise of the rights of the parent company over the assets or management of that undertaking'; or
- d** 'where the interest of the parent company is held exclusively with a view to subsequent resale and the undertaking has not previously been included in consolidated group accounts prepared by the parent company';

Required exclusion

- e** 'where the activities of one or more subsidiary undertakings are so different from those of other undertakings to be included in the consolidation that their inclusion would be incompatible with the obligation to give a true and fair view'.

77 Within this statutory framework, the FRS elaborates on the conditions for exclusion set out in the Act so that these identify, as far as possible, only those undertakings, defined as subsidiary undertakings by section 258, that are not controlled by their parent undertaking in a way that would in principle justify consolidation. This gives effect to the Board's view that a parent undertaking should consolidate all those undertakings that are its subsidiary undertakings unless there are circumstances that make consolidation inappropriate. Under the circumstances set out in paragraph 78(c) and (d) below, the FRS requires the parent undertaking to exclude a subsidiary undertaking because the same conditions that justify permitting exclusion of a subsidiary undertaking also make consolidation of that undertaking inappropriate. Exclusion from consolidation is not the only way of clarifying the effect on the group of the circumstances affecting some of its subsidiary undertakings; exclusion should only be used exceptionally. In many cases circumstances, such as restrictions or activities with special risks, are better dealt with by disclosure, for example by giving additional segmental information, rather than by exclusion from consolidation of the subsidiary undertakings concerned.

78 In order to help preparers identify the exceptional cases where it is inappropriate to consolidate a subsidiary undertaking, the exclusions allowed or required by section 229(2)-(4) are discussed below.

Materiality

- a** The FRS deals only with material items. Thus this ground for exclusion requires no special mention in the FRS. The Act only allows exclusion for two or more subsidiary undertakings if they are not material taken together.

Disproportionate expense and undue delay

- b** In principle neither expense nor delay can justify excluding from consolidation subsidiary undertakings that are individually or collectively material in the context of the group.

Severe long-term restrictions

- c** Restrictions are only relevant to justify the exclusion of a subsidiary undertaking from consolidation if the restrictions substantially hinder the exercise of the rights of the parent undertaking over the assets or management of the subsidiary undertaking. The rights affected must be those by reason of which the undertaking holding them is the parent undertaking and without which it would not be the parent undertaking. Severe long-term restrictions justify excluding a subsidiary undertaking from consolidation only where the effect of those restrictions is that the parent undertaking does not control its subsidiary undertaking. Severe long-term restrictions are identified by their effect in practice rather than by the way in which the restrictions are imposed. For example, a subsidiary undertaking should not be excluded because restrictions are threatened or because another party has the power to impose them unless such threats or the existence of such a power has a severe and restricting effect in practice in the longterm on the rights of the parent undertaking. Generally, restrictions are dealt with better by disclosure than by non-consolidation. However, the loss of the parent undertaking's control over its subsidiary undertaking resulting from severe long-term restrictions would make it misleading to include that subsidiary undertaking in the consolidation. Where a subsidiary undertaking is subject to an insolvency procedure in the United Kingdom, control over that undertaking may have passed to a designated

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official (for example, an administrator, administrative receiver or liquidator) with the effect that severe long-term restrictions are in force. A company voluntary arrangement does not necessarily lead to loss of control. In some overseas jurisdictions even formal insolvency procedures may not amount to loss of control.

Interest held exclusively with a view to subsequent resale

- d** This exclusion applies only to those undertakings that have never formed a continuing part of group activities and have not previously been included in consolidated financial statements prepared by the parent undertaking. Paragraph 11 defines the two sets of circumstances in which an interest in a subsidiary undertaking is considered to be held exclusively with a view to subsequent resale. The first set of circumstances (paragraph II(a)) depends on an immediate intention to sell and the expectation of a sale within approximately one year. An interest for which a sale is not completed within a year of its acquisition may still fulfil the conditions of paragraph II(a) if, at the date the accounts are signed, the terms of the sale have been agreed and the process of disposing of that interest is substantially complete. The second set of circumstances (paragraph II(b)) depends on the way in which the interest was acquired, that is, whether it was acquired as a result of the enforcement of a security. The provisions of Schedule 10A paragraph 8(b) may be relevant in determining whether such an interest has been acquired. This paragraph provides that rights attached to shares held as a security are to be treated as held by the person providing the security, where the shares are held in connection with the granting of loans as part of normal business activities and, apart from the right to exercise them to preserve the value of the security or to realise it, the rights are exercisable only in the interests of the provider of the security.

Different activities

- e** The key feature of this exclusion is that it refers only to a subsidiary undertaking whose activities are so different from those of other undertakings included in the consolidation that to include that subsidiary undertaking in the consolidation would be incompatible with the obligation to give a true and fair view. Cases of this sort are so exceptional that it would be misleading to link them in general to any particular contrast of activities. For example, the contrast between Schedule 9 and 9A companies (banking and insurance companies and groups) and other companies or between profit and not-for-profit undertakings is not sufficient of itself to justify non-consolidation. The different activities of undertakings included in the consolidation can better be shown by presenting segmental information rather than by excluding from consolidation the subsidiary undertakings with different activities.

79 *Treatment of excluded subsidiary undertakings*

Severe long-term restrictions

- a** Where severe long-term restrictions are in force so that a subsidiary undertaking is no longer under the control of its parent undertaking, that subsidiary undertaking should not be consolidated. From the date severe long-term restrictions come into force and until they are lifted, the subsidiary undertaking subject to the restrictions should be excluded from consolidation and treated instead as a fixed asset investment. If restrictions are in force when the subsidiary undertaking is acquired, it should be carried initially at cost; if restrictions came into force at a later date, the subsidiary undertaking should be carried at a fixed amount calculated using the equity method as at the date the restrictions came into force. If, in spite of severe long-term restrictions, the parent undertaking retains significant influence over a subsidiary undertaking, the investment should be treated as an associated undertaking using the equity method. Because severe long-term restrictions may give rise to diminutions in value, the FRS requires the value of the excluded subsidiary undertaking to be reviewed to assess whether any permanent diminution in value has occurred. Any intra-group amounts due from such excluded subsidiary undertakings may also be affected by severe long-term restrictions, particularly if the restrictions extend to remittances. These balances should also be reviewed and provision made as necessary.

Held exclusively for resale

- b** A subsidiary undertaking held exclusively for resale and not previously included in the consolidated financial statements of the parent undertaking does not form part of the continuing activities of the group. Although the parent undertaking (as identified by section 258 and paragraph 14 of the FRS) may control such a subsidiary undertaking, its control is temporary and is not used to deploy the underlying assets and liabilities of that subsidiary undertaking as part of

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the continuing group's activities for the benefit of the parent undertaking of the group. The subsidiary undertaking is therefore excluded from consolidation and the temporary nature of the parent undertaking's interest is recognised by carrying it as a current asset at the lower of cost and net realisable value.

Different activities make consolidation incompatible with giving a true and fair view

- c Even where a subsidiary undertaking's activities are, exceptionally, so different from those of other undertakings included in the consolidation that its consolidation is not compatible with the obligation to give a true and fair view, that subsidiary undertaking contributes to the wealth and performance of the group. The net assets and results of such a subsidiary undertaking should, therefore, be reflected in the consolidated financial statements and, because it is inappropriate to do this by consolidation, the equity method should be used instead. The use of the equity method is required by Schedule 4A paragraph 18. The FRS also requires separate financial statements for such excluded subsidiary undertakings to accompany the consolidated financial statements so that the information given is complete and fully reflects the different types of assets and liabilities used in the activities of the group as a whole.

Intra-group guarantees re excluded subsidiary undertakings

- d Liabilities to third parties of one group member guaranteed by another are themselves included in the consolidated financial statements so that intra-group guarantees do not normally require disclosure. Guarantees in respect of subsidiary undertakings excluded from consolidation have to be treated in the same way as guarantees given by members of the group to third parties because, in these cases, the intra-group guarantees relate to liabilities that are not included gross in the consolidated financial statements.

Minority interests

- 80 Despite the title 'Minority interests', there is in principle no upper limit to the proportion of shares in a subsidiary undertaking which may be held as a minority interest while the parent undertaking still qualifies as such under section 258 of the Act (described in paragraph 14 of the FRS). The amounts reported in the consolidated balance sheet and profit and loss account for the minority interests indicate the extent to which the assets and liabilities and profits and losses of subsidiary undertakings included in the consolidation are attributable to shareholders other than the parent or its other subsidiary undertakings. The effect of the existence of minority interests on the returns to investors in the parent undertaking is best reflected by presenting the net identifiable assets attributable to minority interests on the same basis as those attributable to group interests. Using the same basis for including group assets and liabilities, irrespective of the extent to which they are attributable to the minority interest, presents the assets and liabilities on a consistent basis for the group as a whole.
- 81 The FRS requires that losses be attributed to the minority interest in a loss making subsidiary undertaking, regardless of whether or not this leads to a debit balance for the minority interest; to do otherwise would obscure the comparison between the assets and liabilities and results attributable to the minority interest and those attributable to the group interests both during the periods when the accumulated losses accrue and afterwards, if these are then made good by later profits. Accumulated losses of subsidiary undertakings do not of themselves necessarily require funding by the parent undertaking and a debit balance for minority interests represents net liabilities attributable to the shares held by the minorities in that subsidiary undertaking rather than a debt due from them. The group should provide for any commercial or legal obligation (whether formal or implied) to provide finance that may not be recoverable in respect of the accumulated losses attributable to the minority interests. Provisions of this sort would include the minorities' share of any liability guaranteed by the group, or any liability that the group itself would be likely to settle for commercial or other reasons, if the subsidiary undertaking could not do so itself. Any provision made with respect to minority debit balances should be set directly against the minority interest amount in the profit and loss account and the balance sheet.
- 82 The FRS requires that the goodwill arising on acquisition of a subsidiary undertaking that is not wholly owned should be recognised only in relation to the group's interest and that none should be attributed to the minority interest. Although it might be possible to estimate by extrapolation or valuation an amount of goodwill attributable to the minority when a subsidiary undertaking is acquired, this would in effect recognise an amount for goodwill that is hypothetical because the minority is not a party to the transaction by which the subsidiary undertaking is acquired.

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Consolidation adjustments and intra-group transactions

- 83** Presenting information about the economic activities of the group as a single economic entity in consolidated financial statements requires adjustment for intra-group transactions of the amounts reported in the individual financial statements of the parent and its subsidiary undertakings. Intra-group transactions may result in a profit or loss that is included at least temporarily in the book value of group assets. To the extent that such assets are still held in the undertakings included in the consolidation at the balance sheet date, the related profits or losses recorded in the individual financial statements have not arisen for the group as a whole and must therefore be eliminated from group results and asset values. The elimination should be in full, even where the transactions involve subsidiary undertakings with minority interests. Transactions between undertakings included in the consolidation deal with the assets and liabilities that are wholly within the group's control, even if they are not wholly owned. From the perspective of the group as a single entity no profit or loss arises on intra-group transactions because no increase or decrease in the group's net assets has occurred. Where there are subsidiary undertakings excluded from consolidation because of their different activities, transactions with those subsidiary undertakings, which would be eliminated if they related wholly to subsidiary undertakings included in the consolidation, should also be eliminated. Profits or losses arising on transactions with undertakings excluded from consolidation because they are held exclusively with a view to subsequent re-sale or because of severe long-term restrictions need not be eliminated, except to the extent appropriate where significant influence is retained and the subsidiary undertaking is treated as an associated undertaking. However, it is important to consider whether it is prudent to record any profit arising from transactions with subsidiary undertakings excluded on these grounds.

Changes in composition of a group

- 84** The date on which an undertaking becomes or ceases to be another undertaking's subsidiary undertaking marks the point at which a new accounting treatment for that undertaking is applied. The relevant date is the date on which control passes and paragraph 45 of the FRS is framed in these terms. This date should also be the one on which an undertaking begins or ceases to qualify as a parent or subsidiary undertaking under section 258. The date on which control passes is a matter of fact and cannot be backdated or otherwise altered.
- 85** Where control is transferred by a public offer, the date control is transferred is the date the offer becomes unconditional, usually as a result of a sufficient number of acceptances being received. For private treaties, the date control is transferred is generally the date an unconditional offer is accepted. Where an undertaking becomes or ceases to be a subsidiary undertaking as a result of the issue or cancellation of shares, the date control is transferred is the date of issue or cancellation. The date that control passes may be indicated by the acquiring party commencing its direction of the operating and financial policies of the acquired undertaking or by changes in the flow of economic benefits. The date on which the consideration for the transfer of control is paid is often an important indication of the date on which a subsidiary undertaking is acquired or disposed of. However, the date the consideration passes is not conclusive evidence of the date of the transfer of control because this date can be set to fall on a date other than that on which control is transferred, with compensation for any lead or lag included in the consideration. Consideration may also be paid in instalments.
- 86** An undertaking may cease to be a subsidiary undertaking as a result of the parent undertaking losing control over it because of changes in the rights it holds or in those held by another party in that subsidiary undertaking. A parent undertaking may also lose control of its subsidiary undertaking because of changes in some other arrangement that gave it control without there being any change in the former parent undertaking's holding in its former subsidiary undertaking. For example, control may pass if there is a change in voting rights or in how these are allocated. In these circumstances neither a gain nor a loss accrues in the consolidated financial statements, unless there is a payment for the transfer of control, because there is no change in the net assets attributable to the group's holding in the former subsidiary undertaking. The assets and liabilities of the former subsidiary undertaking should cease to be consolidated but should be shown instead as an associated undertaking or investment as appropriate.
- 87** An undertaking usually ceases to be a subsidiary undertaking because the group reduces its proportional interest in that undertaking. The reduction of the group's interest may result from its directly disposing of part of the interest it holds or from a deemed disposal. Any reduction in the group's proportional interest other than by a direct disposal is a deemed disposal. Disposals and deemed disposals may give rise to

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profits or losses for the group, which should be calculated as set out in paragraph 47. There may be other losses or gains that arise for the group as a result of an undertaking ceasing to be a subsidiary undertaking. These are not part of the direct gain or loss described here but may need to be provided for, if they are quantifiable, or otherwise disclosed to show the full effect of the cessation. Deemed disposals may arise where the group's interest in a subsidiary undertaking is reduced, inter alia:

- a because the parent undertaking and its group do not take up their full allocation of rights in a rights issue; or
- b because the parent undertaking and its group do not take up their full share of scrip dividends while other equity holders in that subsidiary undertaking take up some, at least, of their share; or
- c because another party has exercised its options or warrants; or
- d because the subsidiary undertaking has issued shares to parties other than the parent undertaking and its group.

Changes in stake

- 88 When an undertaking is first consolidated, its identifiable assets and liabilities are initially brought into the consolidation at their fair values at the date of its acquisition as a subsidiary undertaking (the acquisition method of accounting as provided by Schedule 4A paragraph 9). Where a subsidiary undertaking is acquired in stages, its net identifiable assets and liabilities are to be included in the consolidation at their fair values on the date it becomes a subsidiary undertaking, rather than at the date of the earlier purchases. Using other methods to compute the amounts to be included in the consolidation would fail to give a full picture of the assets and liabilities acquired that now comprise part of the group's resources.
- 89 The effect of the Schedule 4A paragraph 9 method of acquisition accounting is to treat as goodwill, or negative goodwill, the whole of the difference between, on the one hand, the fair value, at the date an undertaking becomes a subsidiary undertaking, of the group's share of its identifiable assets and liabilities and, on the other hand, the total acquisition cost of the interests held by the group in that subsidiary undertaking. This applies even where part of the acquisition cost arises from purchases of interests at earlier dates. In the generality of cases this method provides a practical means of applying acquisition accounting because it does not require retrospective assessments of the fair values of the identifiable assets and liabilities of the acquired undertaking. In special circumstances, however, not using fair values at the dates of earlier purchases, while using an acquisition cost part of which relates to earlier purchases, may result in accounting that is inconsistent with the way the investment has been treated previously and, for that reason, may fail to give a true and fair view. For example, an undertaking that has been treated as an associated undertaking by a group may then be acquired by that group as a subsidiary undertaking. Using the method required by Schedule 4A paragraph 9 to calculate goodwill on such an acquisition has the effect that the group's share of profits or losses and reserve movements of its associated undertaking becomes reclassified as goodwill (usually negative goodwill). A similar problem may arise where the group has substantially restated its investment in an undertaking that subsequently becomes its subsidiary undertaking. For example, where a provision has been made against such an investment for permanent diminution in value, the effect of applying the Schedule 4A paragraph 9 method of acquisition accounting would be to increase reserves and create an asset (goodwill). In the rare cases where the Schedule 4A paragraph 9 calculation of goodwill would be misleading, goodwill should be calculated as the sum of goodwill arising from each purchase of an interest in the relevant undertaking adjusted as necessary for any subsequent diminution in value. Goodwill arising on each purchase should be calculated as the difference between the cost of that purchase and the fair value at the date of that purchase of the identifiable assets and liabilities attributable to the interest purchased. The difference between the goodwill calculated on this method and that calculated on the method provided by the Act is shown in reserves. Section 227(6) sets out the disclosures required in cases where the statutory requirement is not applied.
- 90 Where a group increases its stake in an undertaking that is already its subsidiary undertaking the consideration paid may not be equal to the fair value of the identifiable assets and liabilities previously attributed to the minority and now acquired from the minority. If the assets and liabilities were not revalued to fair values before calculating the goodwill arising on the change in stake, then the difference between the consideration paid and the relevant proportion of the carrying value of net assets acquired

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would be made up in part of goodwill and in part of changes in value. The FRS requires that the assets and liabilities of the subsidiary undertaking be revalued to fair value at the date of the increase in stake unless the difference between the fair values and the carrying amounts of the share of net assets acquired is not material.

- 91** Where the group decreases its stake in an undertaking whether or not it continues to be a subsidiary undertaking, a profit or loss generally arises. Consolidated financial statements are prepared from the perspective of investors in the parent undertaking of the group. Where the group disposes of part of its interest in a subsidiary undertaking it transacts directly with third parties and a profit or loss for the group arises and is reported in the consolidated financial statements. This can be contrasted with the treatment of intra-group transactions where no profit or loss arises for the group as a whole because the transaction involves only undertakings included in the consolidation and under common control and does not directly involve any third party.

Distributions

- 92** SSAP 15 'Accounting for deferred tax' states that the retention of earnings overseas will create a timing difference only if:
- a** there is an intention or obligation to remit them; and
 - b** remittance would result in a tax liability after taking account of any related double tax relief

It also requires that, where deferred tax is not provided on earnings retained overseas, this should be stated. In addition this FRS requires disclosure of the extent to which deferred tax has been accounted for in respect of future remittances of the accumulated reserves of overseas subsidiary undertakings. Where deferred tax has not been provided for in full, the reason for not providing fully should be given, for example, that the amounts are considered to be permanently re-invested overseas and are not intended to be remitted.

Disclosures

- 93** The FRS refers to the disclosure requirements of the Act and, where appropriate, adds further disclosure requirements of its own. By referring to certain of the disclosure requirements in the Act in the text of the statement of standard accounting practice the FRS extends these disclosure requirements to parent undertakings not subject to the Act. Requirements of the Act are identified by section or schedule numbers; reference to the Act itself is necessary to ascertain the full disclosures required.

Segmental information

- 94** Segmental information has a particular importance in group financial reporting. The aggregation and adjustments required to consolidate financial information for the parent undertaking and its subsidiary undertakings may obscure information about the different undertakings and activities included in the consolidated financial statements. The information about the separate group activities that may be obscured by consolidation can be restored by giving information about the group on a segmental basis. Parent undertakings should consider how to provide segmental information for their group, indicating the different risks and rewards, growth and prospects of the different parts of the group and treating the requirements of SSAP 25 'Segmental reporting' as a minimum rather than a limit to disclosure. Two examples of how segmental information could supplement consolidated financial statements are given below.

Segmentation rather than exclusion for certain subsidiary undertakings

- a** Where the FRS discusses excluding subsidiary undertakings from consolidation, it stresses the importance of the completeness of the information presented in the consolidated financial statements. Thus, where subsidiary undertakings engage in different activities or are subject to certain restrictions that are not such as to require exclusion from consolidation under the FRS, the most complete picture is presented by consolidating the subsidiary undertakings concerned and giving additional information or by identifying the assets, liabilities and results attributable to undertakings engaging in those activities or subject to those restrictions.

Minority interests

- b** Users of consolidated financial statements who are interested in assessing the effect of the existence of minority interests in certain parts of the group on the expected returns to investors in the parent undertaking may find it helpful to have information showing the amounts attributable to the minority interest in different group segments.

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NOTE OF LEGAL REQUIREMENTS

Legal requirements in Great Britain

References are to the Companies Act 1985 as amended by the Companies Act 1989.

Readers should refer to the Act itself for an understanding of the relevant points of law. This section lists only the main sections in the Act containing provisions in relation to subsidiary undertakings. The provisions of the Act are not considered further here because they are dealt with in the many references to the Act in the other sections of the FRS.

Main sections of the Companies Act

- 95** The main sections of the Companies Act containing provisions relating to the preparation of consolidated financial statements are the following.

Section 227	'Duty to prepare group accounts'
Section 228	'Exemption for parent companies included in accounts of larger group'
Section 229	'Subsidiary undertakings included in the consolidation'
Section 230	'Treatment of individual profit and loss account where group accounts prepared'
Section 231	'Disclosure required in notes to accounts:- related undertakings'
Section 248	'Exemption for small and medium-sized groups'
Section 249	'Qualification of group as small or medium-sized'
Section 258	'Parent and subsidiary undertakings'
Section 259	'Meaning of "undertaking" and related expressions'
Section 260	'Participating interests'
Section 262	'Minor definitions'
Section 262A	'Index of defined expressions'
Schedule 4A	'Form and Content of Group Accounts'
(All paragraphs)	
Schedule 5	'Disclosure of Information: Related Undertakings'
(All paragraphs)	
Schedule 10A	'Parent and Subsidiary Undertakings:
(All paragraphs)	Supplementary Provisions'

Disclosure requirements

- 96** The following sections and paragraphs give the main disclosure requirements of the Act with respect to consolidated financial statements.

Section 227(4) -(6) Section 228(2) Section 231 Schedule 4A - Paragraphs 3, 4, 13, 14, 15, 17 Schedule 5 - 'Disclosure of Information: Related Undertakings' Part I - 'Companies not Required to Prepare Group Accounts' Part 11- 'Companies Required to Prepare Group Accounts'

Legal requirements in Northern Ireland

- 97** The legal requirements in Northern Ireland are very similar to those in Great Britain. The following table shows the Articles and Schedules in the Companies (Northern Ireland) Order 1986 which correspond to the legal references in paragraphs 95-96 above.

<i>Companies Act 1985 (as amended)</i>	<i>The Companies (Northern Ireland) Order 1986 (as amended)</i>
Section 227	Article 235
Section 228	Article 236
Section 229	Article 237
Section 230	Article 238
Section 231	Article 239
Section 248	Article 256

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*Companies Act 1985
(as amended)*

Section 249
Section 258
Section 259
Section 260
Section 262
Section 262A

Schedules

Schedule 4A (*all paragraphs*)
Schedule 5 (Parts I & II)
(*all paragraphs*)
Schedule 10A (*all paragraphs*)

*The Companies (Northern Ireland)
Order 1986 (as amended)*

Article 257
Article 266
Article 267
Article 268
Article 270
Article 270A

Schedule 4A (*all paragraphs*)
Schedule 5 (Parts I & II)
(*all paragraphs*)
Schedule 10A (*all paragraphs*)

Legal requirements in the Republic of Ireland

- 98** The principal legislation is contained in the European Communities (Companies: Group Accounts) Regulations 1992 ("the Regulations"), SI No 201 of 1992, which implement the EC Seventh Directive. The Regulations amend certain group accounts related provisions in the Companies Acts 1963 - 1990 and also apply provisions in that legislation to group accounts.

This section is not a summary of all the legal provisions related to group accounts. It gives a listing of the contents of the Regulations and the Irish equivalent for UK legal references.

Readers are advised to refer to the Regulations for an understanding of relevant legal points.

*European Communities (Companies: Group Accounts) regulations
- contents*

Regulation 1	Citation, commencement, and construction
Regulation 2	Application
Regulation 3	Interpretation
Regulation 4	Subsidiary undertaking - definition
Regulations 5 & 6	Requirement to present group accounts
Regulations 7 - 9	Exemptions from requirement to present group accounts
Regulations 10 - 12	Exclusions from consolidation
Regulations 13 & 14	General provisions in relation to group accounts
Regulation 15	Format of accounts
Regulation 16	Group balance sheet and group profit and loss account
Regulations 17 & 18	Acquisition and merger accounting
Regulations 19 & 20	The acquisition method of accounting
Regulations 21 & 22	The merger method of accounting
Regulation 23	Acquisition of a group
Regulations 24 - 26	Methods of consolidation
Regulation 27	Changes in composition of a group
Regulations 28 - 31	Valuation
Regulation 32	Joint ventures
Regulations 33 & 34	Associated undertakings - equity, method of accounting
Regulation 35	Participating interest
Regulations 36 - 40	Publication of information
Regulation 41	Offences
Regulations 42 - 45	Amendments to the Companies (Amendment) Act 1986
<i>Schedule</i>	
Part I paragraphs 1 - 10	Amendments to the schedule to the Companies (Amendment) Act 1986
Part 2 paragraphs 11 - 23	Information required by way of notes to the group accounts

*Table of equivalent legal references in the Republic of Ireland**References in text*

	FRS 2	GB REFERENCE	ROI REFERENCE
<i>Summary</i>	para a	Companies Act 1985 as amended by the Companies Act 1989 ("the Act")	The Companies Acts 1963-1990 and the European Communities (Companies: Group Accounts) Regulations 1992 ("the Regulations")
	para e	section 228 section 229 section 248	Regulations 8 & 9 Regulations 10-12 Regulations 6 & 7
	para p	-	The date of application is accounting periods beginning on or after 1st September 1992
<i>Statement of Standard Accounting Practice</i>	para 7a	section 258(2)(c)	Regulation 4(1)(b)
	para 14	section 258	Regulation 4
	para 21a	section 248	Regulations 6 & 7
	para 21b	section 228(2)	Regulation 8
	para 21c	section 228(l)(b)	Regulation 8
	para 21d	section 229	Regulations 10-12
	para 22	Companies Act Schedule 5 Part 1	Regulation 8 (3) (d)
	para 25	section 229(3) and (4)	Regulations 11 & 12
	para 25a	section 258	Regulation 4
	para 26	section 231	Companies (Amendment) Act 1986, section 16
	para 31	section 231 and Schedule 5	Companies (Amendment) Act 1986, section 16
	para 32	section 229	Regulations 11 & 12
	para 33	section 231	Companies (Amendment) Act 1986, Section 16
	para 34	section 231 Schedule 5, 15(5)	
	para 35	Schedule 4A 17(2)	Regulations, Schedule para 8
	para 36	Schedule 4A 17(3) Schedule 4A 17(4)	Regulations, Schedule para 9
	para 41	Schedule 4A para 3(2)	Regulation 29(3)

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	FRS 2	GB REFERENCE	ROI REFERENCE
	para 45	Schedule 4A para 9	Regulation 19
	para 48	Schedule 4A para 15	Regulation 27
	para 50	Schedule 4A para 9	Regulation 19
	para 55	-	The date of application is accounting periods beginning on or after 1st September 1992
<i>Explanation</i>	para 62	section 258	Regulation 4
	para 66	section 258	Regulation 4
	para 68	section 258	Regulation 4
	para 69	section 258	Regulation 4
	para 70	section 258(2)(c) Schedule 10A para 4(1)	Regulation 4(1)(b) Regulation 4(5)
	para 71	section 258(4)(a) Schedule 10A para 4(3) section 258(2)(c)	Regulation 4(1)(c)(i) Regulation 4(7) Regulation 4(1)(a)(ii)
	para 74	section 258(4)(b)	Regulation 4(1)(C)(ii)
	para 76	section 229(2)-(4)	Regulations 10-12
	para 77	section 258	Regulation 4
	para 78	section 229(2)-(4)	Regulations 10-12
	para 80	section 258	Regulation 4
	para 84	section 258	Regulation 4
	para 88	section 258	Regulation 4
	para 89	Schedule 4A para 9 section 227(6) section 258	Regulations 19-20 Regulation 14(3) Regulation 4

References in footnotes

FRS 2	ROI REFERENCE
para I**	European Communities (Companies: Group Accounts) Regulations 1992
para 38 *	Regulation 19(2) - Acquisitions Regulation 22(2) - Mergers

References in margins

FRS2	ROI REFERENCE	FRS2	ROI REFERENCE
para 7a	Regulation 4(5)	para 25	Regulations 11 & 12
para 7b	No Irish equivalent	para 25a	Regulation 11(a)
para 10	No Irish equivalent	para 25b	Regulation 11(c)
para 11	Regulation 11(c)	para 25c	Regulation 12(1)
para 12	Regulation 4(1)(c)(ii)	para 26	Companies (Amendment)
para 13	Regulation Schedule 8(2)		Act 1986 section 16
para 14	Regulation 4	para 30	Regulation 12(1)
para 14a	Regulation 4 (1) (a) (i)	para 31	Companies (Amendment)
			Act 1986 section 16
para 14b	Regulation 4(l)(a)(ii)&4(2)	para 33	Companies (Amendment)
para 14c	Regulation 4(1)(b)		Act 1986 section 16
para 14c (ii)	Regulation 4(1)(b)(ii)	para 34	
para 14d	Regulation 4(1)(a)(iii)	para 35	Regulation Schedule para 8
para 14e	Regulation 4(1)(c)	para 36	Regulation Schedule para 9
para 14f	Regulation 4(1)(d)		(1-3)
para 15	Regulation 35	para 39	Regulations specify that
para 16	Regulation 3(1)		elimination should only
para 17	Regulation 3(4)		refer to "undertakings
para 20	Regulation 5(1)		dealt within the Group
para 21a	Regulations 5 & 6		Accounts", ie the FRS
para 21b	Regulations 8 & 9		goes further than the
para 21c	Regulations 8 & 9		Regulations
para 21d	Regulations 10 & 11	para 40	Regulations refer to
			uniform valuation methods
para 23	Regulation 5(2)	para 43	Regulation 26(2)
para 24	Regulation 11(b)	para 44	No Irish equivalent
		para 46	No Irish equivalent

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THE DEVELOPMENT OF THE STANDARD

This section does not form part of the Financial Reporting Standard.

History of the FRS

- i Statement of Standard Accounting Practice No 14 (SSAP 14) 'Group accounts', issued September 1978, dealt with the presentation of group accounts for a group of companies. The practice of preparing group accounts for companies and their subsidiaries had been well established in the United Kingdom and Ireland since 1947. However, the issue of International Accounting Standard No 3 'Consolidated Financial Statements' made it desirable for there to be a domestic standard on the subject.
- ii SSAP 14 was drafted to accord with relevant provisions of the Companies Acts then in force. At that time the Companies Acts did not include detailed rules regarding the preparation of group accounts.
- iii SSAP 14 defined a holding company and a subsidiary company by reference to the legal definitions current at that time. The terms now used are 'parent undertaking' and 'subsidiary undertaking' which are defined in the Companies Act 1985, as amended by the Companies Act 1989 (the Act). The Act now contains new provisions on group accounts to implement the European Community Seventh Company Law Directive with the result that the requirements of SSAP 14 are no longer entirely consistent with current legislation.
- iv The need to revise SSAP 14 for changes in the law has provided an opportunity to conduct a thorough review of the standard. This was undertaken initially by the Accounting Standards Committee whose proposals were issued as ED 50 'Consolidated accounts' in June 1990. The Accounting Standards Board issued the 'Interim Statement: Consolidated accounts' in December 1990, to give timely guidance on how certain provisions of the Act were to be interpreted in the preparation of consolidated accounts. The Interim Statement also made the changes to SSAP 14 'Group accounts' that were required as a consequence of the statutory changes. The issue of the FRS by the Accounting Standards Board completes the review process.

Summary of the principal changes from Statement of Standard Accounting Practice No 14 - 'Group Accounts'

- v SSAP 14 defined a company as a subsidiary of another 'if, but only if,
 - a that other either:
 - i is a member of it and controls the composition of its board of directors; or
 - ii holds more than half in nominal value of its equity share capital; or
 - b the first mentioned company is a subsidiary of any company which is that other's subsidiary, and it otherwise comes within the terms of section 154 of the Companies Act 1948' (now repealed).

The FRS defines a parent undertaking and a subsidiary undertaking in the same way as the Act using a set of conditions that are based on whether one undertaking controls another. These are set out in paragraph 14 of the FRS.

- vi The FRS requires a parent undertaking not making use of an exemption to prepare consolidated financial statements for its group. SSAP 14 exceptionally allowed alternative forms of group reporting if the resulting group accounts were considered to give a fairer view of the financial position of the group as a whole than would consolidated financial statements.
- vii SSAP 14 exempted from the obligation to prepare group accounts only holding companies that were wholly owned subsidiaries not otherwise required by law to prepare group accounts. The FRS follows the Act in allowing other exemptions from preparing consolidated financial statements. A parent undertaking is in general exempt from the requirement to prepare consolidated financial statements if its group is a small or medium-sized one; or if it is wholly or majority-owned by an undertaking established under the law of a member state of the European Community; or if all its subsidiary undertakings fall within the exclusions from consolidation.

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- viii** The circumstances in which subsidiary undertakings are to be excluded from the consolidation have changed in certain respects from those in SSAP 14.
- a** SSAP 14 required a subsidiary to be excluded from consolidation if its activities were so dissimilar from those of other companies within the group that its consolidation would be misleading and information would be better provided by presenting financial statements for the excluded subsidiary separate from the financial statements for the rest of the group. The FRS requires a subsidiary undertaking to be excluded from consolidation if, exceptionally, its activities are so different from other subsidiary undertakings included in the consolidation that its inclusion in the consolidation would be incompatible with the obligation to give a true and fair view.
- b** SSAP 14 required a subsidiary to be excluded from consolidation if the holding company held more than half of the subsidiary's equity share capital but either: (a) it did not own share capital carrying more than half the votes; or (b) contractual or other restrictions were imposed on its ability to appoint the majority of the board of directors. Although the FRS does not have the same exclusion, the FRS will in most cases have the same practical effect because (a) an undertaking is a subsidiary undertaking if another undertaking holds a majority of its voting rights and (b) exclusion is required where severe long-term restrictions substantially hinder the rights of the parent undertaking over the assets or management of its subsidiary undertaking.
- c** SSAP 14 required exclusion from consolidation of a subsidiary where control was intended to be temporary. The FRS requires consolidation where one undertaking controls another and, therefore, has not based exclusion on control being temporary. However, it does require exclusion from consolidation of a subsidiary undertaking held exclusively with a view to resale which has not previously been consolidated. This condition for exclusion is more restrictive than the temporary control test.
- ix** SSAP 14 required that the consolidated financial statements should contain sufficient information about material subsidiaries acquired or sold to enable shareholders to appreciate the effect on the consolidated results. There are now specific disclosure requirements in the law, as well as in accounting standards in respect of acquisitions, and the general SSAP 14 requirement is not repeated in the FRS. In addition FRS I 'Cash flow statements' contains a requirement to show the cash flow effects of acquisitions and disposals.
- x** SSAP 14 sets out the effective date of acquisition or disposal as the earlier of the date on which consideration passes or the date on which an offer becomes or is declared unconditional. This is replaced in the FRS by a single triggering date which is the date control of the undertaking passes. This date is a matter of fact and cannot be backdated or otherwise altered.
- xi** SSAP 14 required that debit balances for the minority interests should only be recognised in the balance sheet if there was a binding obligation on minority shareholders to make good losses incurred which they were able to meet. The FRS requires minority interests to be debited in full with their share of any loss whether or not this results in a debit balance, subject to the need for a provision discussed below. A debit for minority interests does not represent a liability of the minority shareholders and it may be misleading to refer to their being obliged to make good losses. The group should make provision to the extent that it has any commercial or legal obligation (whether formal or implied) to provide finance that may not be recoverable in respect of the accumulated losses attributable to minority interests.

Summary of the principal changes from the Board's 'Interim Statement: Consolidated Accounts'

- xii** In December 1990 the Board issued the 'Interim Statement: Consolidated Accounts' to give timely guidance on the application of certain provisions of the new Act to the preparation of consolidated financial statements. The Interim Statement dealt mainly with the interpretation of the new phrases used in the conditions that identified parent and subsidiary undertakings and with the exclusions from consolidation permitted or required by the Act for certain subsidiary undertakings. Although the drafting has changed to fit the format of an accounting standard, the FRS incorporates the guidance given by the Interim Statement except in the following areas.

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- a** Dominant influence is now defined without explicit reference to control although the effect of dominant influence is the same as control.
- b** The explanation dealing with subsidiary undertakings whose activities are so different that consolidation is incompatible with the obligation to give a true and fair view now states explicitly that the contrast between Schedule g and 9A companies and other companies or between profit and not-for-profit undertakings is not sufficient of itself to justify non consolidation.
- c** The Interim Statement defined a joint venture. The FRS deals only with accounting for subsidiary undertakings leaving joint ventures as a separate project.

Summary of the principal changes from Exposure Draft No 50 'Consolidated accounts'

- xiii** Exposure Draft No 50 (ED 50) 'Consolidated accounts' was issued in June 1990 by the Accounting Standards Committee. It proposed standard accounting practice for the preparation of consolidated accounts covering both accounting for subsidiary undertakings and accounting for associated undertakings and joint ventures. The FRS deals only with accounting for subsidiary undertakings in consolidated financial statements. The Board is engaged in another project considering accounting for associated undertakings and joint ventures.
- xiv** The Explanatory Note in ED 50 considered the purpose of consolidated accounts, the basis of consolidation and the meaning of control. The FRS deals only briefly in its explanation section with the conceptual background to financial reporting for groups. The conceptual basis of consolidated financial statements and consideration of the group as a reporting entity are to be considered by the Board in the chapter of its Statement of Principles dealing with the boundaries of the reporting entity.
- xv** ED 50 used the terms 'subsidiary', 'parent' and 'enterprise' in line with earlier accounting standards. Commentators on its proposals considered that it would be more appropriate to use the terminology of the Act on which the FRS is based. The FRS now refers to 'subsidiary undertaking', 'parent undertaking' and 'undertaking'. However, in line with the Board's other published work, the FRS uses 'financial statements' instead of 'accounts' as used in the Act.
- xvi** ED 50 proposed definitions for the phrases used in the Act in the criteria for identifying parent and subsidiary undertakings. The FRS elaborates on these definitions in the light of the comments received on the ED. The general thrust of the definitions remains the same but the following changes are worth noting:
 - a** 'Dominant influence' is no longer defined in terms of control but by its ability to achieve the operating and financial policies desired by the holder of the influence, notwithstanding the rights or influence of any other party. The actual exercise of dominant influence is identified by its effect in practice rather than the way in which it is exercised. The effect of dominant influence is the same as the effect of control.
 - b** The role of reserve powers and powers of veto in the actual exercise of dominant influence has been clarified.
- xvii** ED 50 proposed that a parent undertaking using an exemption from preparing consolidated accounts should make additional disclosures if its individual financial statements alone were not sufficient to give a true and fair view of its financial position. ED 50 noted that in some cases such additional information might better be presented by providing consolidated financial statements for the whole group. This proposal attracted adverse comment because, in certain circumstances, its effect would be to take away an exemption given by the Act. The FRS requires a parent undertaking using an exemption to state that its financial statements present information about it as an individual undertaking and not about its group. Parent undertakings using any of the exemptions should also make the disclosures set out in Schedule 5 Part I of the Companies Act.
- xviii** ED 50 proposed definitions for the phrases used in the Act to set the conditions under which a subsidiary undertaking was permitted or required to be excluded from consolidation. As a result of the comments received the guidance of the FRS on how these conditions are to be interpreted has changed slightly from that given in ED 50 although the emphasis remains on interpreting these conditions restrictively. The main changes are set out below.

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- a** *Interests held exclusively with a view to subsequent resale.* A second part has been added bringing acquisitions as a result of the enforcement of a security within the definition of interests held exclusively with a view to subsequent resale unless the subsidiary undertaking has become part of the continuing activities of the group or the holder acts as if it intends the interest to become so.
- b** *Activities so different that consolidation would be incompatible with the obligation to give a true and fair view.* ED 50 proposed that such an incompatibility could arise only from consolidating a Schedule 9 or 9A company with non Schedule 9 or 9A companies. Several commentators considered that a requirement not to consolidate Schedule 9 and 9A companies with others might result in a loss of useful and comparable information on group activities as a whole. Linking incompatibility with the true and fair view to issues relating to the format in which financial statements were presented was considered unsatisfactory. The FRS, therefore, stresses that the key feature of this exclusion is that including a given subsidiary undertaking in the consolidation is incompatible with the obligation to give a true and fair view. The FRS notes that this incompatibility will be so exceptional in practice that it would be misleading to associate it with any particular contrast of activities. For example, the contrasts between Schedule 9 or 9A companies and other companies or between profit and not-for-profit undertakings would not of themselves be sufficient to justify non consolidation.
- xix** ED 50 followed SSAP 14 and proposed that losses should only be debited to minority interests where they resulted in a debit balance if there was a binding and reliable obligation on the minority to make good any such losses. The FRS'S treatment for the minority's share of losses is explained in paragraph xi above.
- xx** ED 50 proposed dropping the requirement of SSAP 14 (paragraph 18) that appropriate adjustments should be made to the consolidated financial statements for any abnormal transactions in the intervening period between the end of the period of a subsidiary and the later one of the group. Commentators considered that some disclosure of this sort would be useful. The FRS requires that, where a subsidiary undertaking's financial year end differs from that of the parent undertaking, the consolidated financial statements should be prepared using interim financial statements or, only if this is impracticable, its financial statements for its last financial year ending not more than three months before that of the group's parent undertaking. In this latter case adjustment is required for changes in the intervening period that materially affect the view given by the consolidated financial statements.
- xxi** ED 50 proposed that the effective date of acquisition or disposal be the earlier of:

 - a** the date on which the consideration passes; or
 - b** the date at which an offer becomes or is declared unconditional; or
 - c** the date of such other event at which control is gained or ceases to exist.

The FRS now sets the date of changes in membership of the group as the date that control passes. The Explanation (paragraphs 84 and 85) considers the transactions and events that indicate when control passes.
- xxii** ED 50 proposed that its requirement to include the appropriate proportion of the results of a subsidiary undertaking that has been disposed of should be subject to the requirements of SSAP 6 'Extraordinary items and prior year adjustments' (paragraphs II-14) dealing with the disposal of a segment. The FRS does not refer to SSAP 6 and requires that the consolidated profit and loss account should include the results of a subsidiary undertaking up to the date of its disposal. The Board is proposing to supersede SSAP 6 with an FRS developed from FRED I 'The Structure of Financial Statements Reporting of Financial Performance'.
- xxiii** The FRS has dropped the proposed requirement of ED 50 in respect of disposals to disclose the amount of purchased goodwill attributable to business or business segments disposed of and how that goodwill has been treated in determining the profit or loss on disposal. These disclosures are still required by paragraph 52(b) of SSAP 22 'Accounting for goodwill'. The treatment of goodwill on disposal is set out in paragraph 47, which requires that the net assets disposed of include any related goodwill not previously written off through the profit and loss account.

- xxiv** In response to criticism of the ED 50 proposals, the FRS changes the treatment for increases in stake in a subsidiary undertaking. ED 50 did not propose to require a revaluation to fair value on an increase in stake, and, consequently, the goodwill balance arising could have consisted of an amount relating to revaluation of net identifiable assets as well as goodwill. The FRS requires that the goodwill should be calculated by revaluing the subsidiary undertaking's assets and liabilities to fair value at the date of the change in stake, unless the difference between fair values and carrying amounts is not material.