ASPE
At a Glance

Section 1591 - Subsidiaries

December 2018

Section 1591 – *Subsidiaries*

Effective Date
Fiscal years beginning on or after January 1, 2016[1]

Scope

Applies to interests in other entities, <u>except for:</u>

- Accounting for investments (see Section 3051), interests in joint arrangements (see Section 3056), or financial instruments (see Section 3856);
- Accounting by investment companies (see AcG-18);
- Employer's accounting for an employee benefit plan subject to Section 3462;
- Accounting for special-purpose entities, including interests in qualifying special-purpose entities as set out in Section 3856 Appendix B; or
- Accounting for contractual arrangements between enterprises under common control.

*Note that the guidance in Section 1591 applies in performing a control assessment for retractable or mandatorily redeemable shares in a tax planning arrangement (RoMRS) when determining whether the criteria for equity classification under paragraph .23 of Section 3856, *Financial Instruments,* are met.

Subsidiary

- An enterprise controlled by another enterprise (the parent) that has the right and ability to obtain future economic benefits from the resources of the enterprise and is exposed to the related risks.
- May take many forms including a corporation, trust, partnership or unincorporated enterprise.

Control

- Control of an enterprise is the continuing power to determine its strategic operating, investing and financing policies without the co-operation of others.
- In determining whether control exists several factors must be considered:
  - Owning, directly or indirectly, an equity interest of 50% or more in an enterprise is usually an indication of control. Despite this, existence of control in a particular situation is a question of fact.
  - Other factors that may be considered in determining whether control exists include: the ability to elect the majority of the members of the board of directors, the provisions of a statute, contractual arrangements, and the ownership of convertible financial instruments.
- When assessing the continuing power to determine the enterprise’s strategic operating, investing and financing policies, only substantive rights relating to another enterprise are considered. For a right to be substantive:
  - The enterprise (the holder) must have the practical ability to exercise that right over the other enterprise (refer to paragraph 1591.14B for factors to consider); and
  - The right also needs to be exercisable when decisions about the direction of the strategic operating, investing or financing policies need to be made.
- Substantive rights exercisable by other parties must also be considered, as they can prevent one party from controlling another party to which those rights relate.
- Protective rights do not confer control onto the holder, as they do not give the holder the power to make decisions about the other enterprise’s activities. Instead, they are designed to protect the interest of the holder (refer to paragraph 1591.21 for examples of protective rights).
- When the rights of equity interests are not the dominate factor in determining control of an enterprise, control may exist through contractual arrangements.
  - Contractual arrangements include: supply arrangements, management contracts, lease agreements, license agreements, royalty contracts, other sales contracts, and finance arrangements.
- Control through contractual rights occurs when an enterprise:
  - Holds rights that are sufficient to direct the strategic operating, investing and financing policies of the other enterprise without the co-operation of others; and
  - It has the right and ability to obtain the future economic benefits and is exposed to the related risks of the other enterprise.
- The following facts and circumstances would be considered when evaluating whether contractual rights are sufficient to give an enterprise control over another enterprise:
  - The degree of involvement in and decisions made at inception in determining the purpose and design of the other enterprise.
  - How decisions are made about strategic policies that could affect:
    - The right and ability to obtain future economic benefits and related risks;
    - Who has the continuing ability to direct the activities of the other enterprise; and
    - Who receives economic benefits and is exposed to the related risks from those activities.
  - The risks to which the other enterprise was designed to be exposed, the risks it was designed to pass on to the parties involved with it, and whether the enterprise is exposed to some or all of those risks. Risks could include: operating, price, credit, liquidity and interest rate risk.
  - Whether the investor has the continuing ability in a contractual arrangement to direct the strategic policies of the other enterprise without the co-operation of others.

[1] Except as specified in paragraph 1591.39.

Recognition

- An enterprise makes an accounting policy choice under paragraph 1591.24 to either:
  a) Consolidate its subsidiaries (see Section 1601, *Consolidated Financial Statements)*; or
  b) Account for subsidiaries it controls through:
     i. Voting interests, potential voting interests, or a combination thereof, using either the cost method (see 1591.26A-.26B) or the equity method (see 1591.27);
     ii. Contractual arrangements according to the nature of contractual arrangements in accordance with the applicable Section, such as a lease (see Section 3065*)*, a financial asset or a financial liability (see Section 3856); and
     iii. Voting interests, potential voting interests or a combination thereof, in combination with contractual arrangements, in accordance with item (i) for the voting interests, potential voting interests, or a combination thereof, and in accordance with item (ii) for the contractual arrangements.

  All of an entity's subsidiaries must be accounted for using the same method. This accounting policy choice does not need to meet the criteria in paragraph 1506.06(b).
- The chosen method must be applied consistently (i.e. when an enterprise accounts for its subsidiaries using the cost or equity method it applies that method in accounting for a change in its ownership interest of the subsidiary).
- When the equity securities of a subsidiary are quoted in an active market, the cost method cannot be used. Instead the enterprise must consolidated the subsidiary, or account for it using the equity method or at its quoted amount, with changes recognized in net income.

When an enterprise chooses under paragraph 1591.24(b) not to consolidate its subsidiaries, it is not required to evaluate its contractual arrangements for evidence of control over another enterprise. Instead, the enterprise accounts for its interests in accordance with other applicable Sections depending on their nature, such as:

- A lease (see Section 3056);
- A financial asset or financial liability (see Section 3856); or
- An investment subject to significant influence (see Section 3051).

Measurement

Cost Method

Initial Measurement

- An enterprise that makes an accounting policy choice to subsequently account for a subsidiary using the cost method, must initially measure the subsidiary on a basis that is similar to other business combinations. In this situation the following accounting must be applied:
  - A subsidiary transferred between enterprises under common control is initially accounted for at cost when the following conditions are met:
    - The transaction is a monetary or non-monetary transaction that has commercial substance (see paragraph 3840.19);
    - The change in the ownership interests in the item transferred is substantive; and
    - The amount of consideration paid or received as established and agreed to by the related parties is supported by independent evidence.

    If these three conditions are not met, the acquiring enterprise initially measures its interest in the subsidiary at the carrying amount as defined in paragraph 3840.03(a).
  - Cost is measured at the acquisition-date fair value of the consideration transferred (including contingent consideration) to the other party in exchange for the interest in the subsidiary (see paragraphs 1582.39-.40).
  - Acquisition-related costs are expensed, except for costs to issue debt and equity securities which are recognized in accordance with Section 3856, *Financial Instruments,* and Section 3610, *Capital Transactions,* respectively.
  - The settlement of pre-existing relationships or other arrangements that are separate from the acquisition of a subsidiary are not included in the cost of the subsidiary (see paragraphs 1582.53-.54 and 1582.A44-.A56).
  - Since an enterprise applying the cost method to the acquisition of a subsidiary does not recognize and measure the assets acquired, liabilities assumed or any non-controlling interest, a bargain purchase gain cannot be recognized.
  - When an enterprise obtains control over another enterprise in stages (step acquisition), the cost of the interest in the subsidiary is the carrying amount of the enterprise's interest in the other enterprise immediately before the date control was acquired plus the cost of the additional interest acquired. The enterprise must assess the carrying amount of the interest in the subsidiary for impairment.
  - If the initial accounting for a subsidiary is incomplete by the end of the reporting period in which the acquisition occurs the carrying amount of the interest in the subsidiary is based on provisional amounts.

Equity Method

- When an enterprise chooses to account for its subsidiaries using the equity method, it applies that method in accordance with Section 3051 and it also must apply the following accounting:
  - At the date of acquisition, contingent consideration for the acquisition of a subsidiary must be measured at fair value and included in the carrying amount of the investment. Subsequently, it must be measured on the same basis required by paragraph 1582.60.
  - Acquisition-related costs must be expensed, except for costs to issue debt and equity securities which must be recognized in accordance with Section 3856 and Section 3610 respectively.

Cost Method (continued)

Subsequent Measurement

- Earnings from subsidiaries are recognized only to the extent received or receivable.
- At the end of each reporting period an enterprise must assess whether its investment in any of its subsidiaries may be impaired (see paragraphs 3051.23-.27).
- Contingent consideration is remeasured when the contingency is resolved on the same basis required by paragraph 1582.60.
- When the initial accounting for a subsidiary was incomplete at the end for the reporting period in which the acquisition occurred, the provisional carrying amount of the interest in the subsidiary is adjusted in the period when the provision amounts are finalized (which cannot exceed one year from the acquisition date) and is not adjusted retrospectively.
- When an ownership interest in a subsidiary increases as a result of an additional acquisition in the subsidiary, the cost of the interest in the subsidiary is the carrying amount of the interest immediate before the acquisition plus the cost of the additional interest acquired, and the enterprise must assess the carrying amount of the interest in the subsidiary for impairment.
- When an ownership interest in a subsidiary decreases as a result of a sale of a portion of the interest, the retained interest is measured as the proportionate share of the carrying amount of the interest in the subsidiary immediately prior to the reduction and any gain or loss is recognized in income. In this situation or in the event of a dilution, the enterprise must assess whether the proceeds from sale/the dilution indicate the remaining carrying amount of the interest may be impaired. If the enterprise loses control of the subsidiary as a result of the transaction, the retained interest is accounted for in accordance with Section 3051 or Section 3856 as appropriate.

Presentation

- When an enterprise accounts for its subsidiaries in accordance with paragraph 1591.24(b), its financial statements are described as being prepared on a non-consolidated basis and each statement is labeled accordingly.
- An enterprises' Balance Sheet must present separately its investments in non-consolidated subsidiaries controlled through voting interests, potential voting interests, or a combination thereof, from other investments.
- Similarly an enterprises' Income Statement must present the income or loss from the above interests in subsidiaries separately.
- Subsidiaries controlled through voting interests, potential voting interests, or a combination thereof, and income / loss from those interests may be presented in an enterprises financial statements with its interests in joint arrangements, if they are accounted for on the same basis (i.e. cost, equity, or fair value).
- When an enterprise applies the cost or equity method, the requirements of Section 3840, *Related Party Transactions,* and Section 3856. *Financial Instruments,* apply to intercompany transactions that would otherwise have been eliminated on consolidation.
- However, the requirements of Section 3840, do not apply to intercompany transactions between a parent and its subsidiaries controlled through means other than voting interest, potential voting interests, or a combination thereof, that would otherwise be eliminated on consolidation when:
  - The enterprise is preparing non-consolidated financial statements; and
  - Control through means other than voting interests, potential voting interests, or a combination thereof, is the only basis of the relationship with the other party.

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