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An illustrative explanation of changes in ownership interests

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IN TUNE ISCA NEWS

ISCA BREAKFAST TALK: AN ILLUSTRATIVE EXPLANATION OF CHANGES IN OWNERSHIP INTERESTS

The ISCA Breakfast Talk on January 15 brought together 94 members to hear from Dr Pearl Tan, Associate Professor (Education), Singapore Management University. Dr Tan explained and illustrated the principles behind the accounting for changes in ownership interests with and without change in control, in Financial Reporting Standard (FRS) 103 *Business Combinations* and FRS 110 *Consolidated Financial Statements*. Although the standards are not new, she emphasised that clarity in their principles is essential in group reporting.

Dr Tan explained the coherent framework of principles and requirements to account for these four scenarios:

- Gain in control;
- Loss of control;
- Increase in ownership interest without change in control, and
- Decrease in ownership interest without change in control.

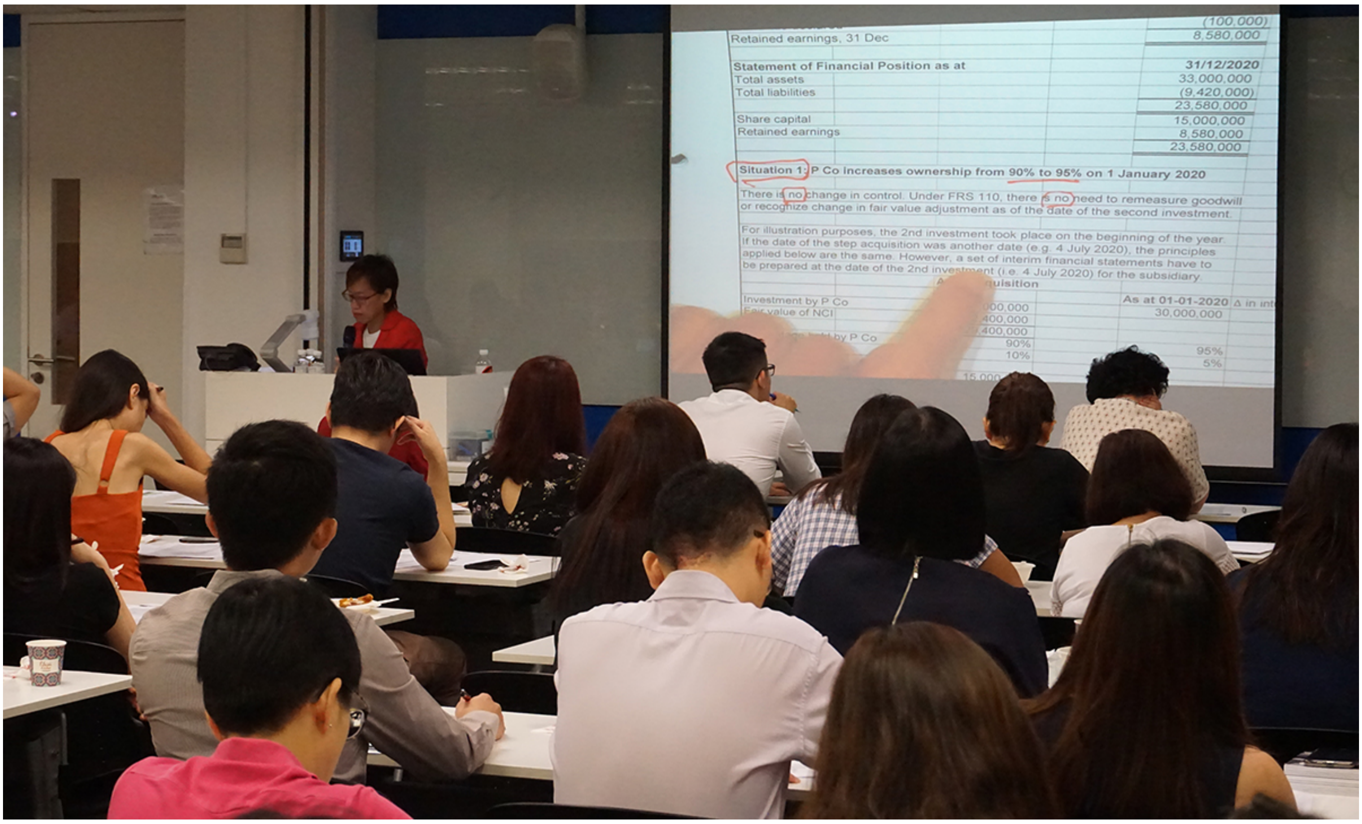
Dr Pearl Tan, Associate Professor (Education), Singapore Management University, explained the underlying principles of changes in ownership interests

Dr Tan went on to elaborate on the concept of de facto control. Moving away from the simplistic view that majority voting rights are presumed to give rise to control, FRS 110 requires a holistic and dynamic evaluation of all the facts and circumstances. In addition to evaluating the sources of power, FRS 110 also requires the demonstration of the ability to use the power to affect returns.

The date when control is obtained or when control is lost is deemed a significant economic event. In a business combination achieved in stages (or a "step acquisition"), the relationship between investor and investee (for example, an associate) changes to one of parent and subsidiary. Conversely, when there is a loss of control, with some interest retained, the parent-subsidiary relationship is replaced with other relationships such as that of an investor-associate. Consequently, the substance of the change may be seen as two transactions: a disposal of a former relationship and an acquisition of a new relationship. In view of the significant economic event brought on by a change in relationship, she explained that the International Accounting Standards Board requires the re-measurement of previously-held interest or retained interest to fair value with the re-measurement gain or loss to be taken to the income statement

FRS 103 does not result in an aggregation of piecemeal goodwill acquired over time. The re-measurement of previously-held interest in the investee to fair value at acquisition date in line with other determinants of goodwill results in a goodwill figure that reflects the conditions on the date when control is obtained. Subsequent to acquisition date, goodwill does not change even though incremental purchases or sales are transacted with non-controlling interests.

Alongside the underlying principles, Dr Tan also illustrated the concepts using illustrative consolidation journal entries where participants had the opportunity to apply the concepts on case study questions.



Participants worked on practical examples to better comprehend the principles behind different scenarios

Dr Tan concluded the session by stating three critical principles when there are changes in ownership interests in a subsidiary without change in control:

First, there is no re-measurement gain or loss because there is no change in the relationship with the subsidiary.
Second, transactions between controlling and non-controlling interests are owner transactions. Hence, gains and losses are to be taken direct to equity and not to the income statement.
Third, there is a "re-balancing" of non-controlling interests to reflect the latest ownership interest. The proof or analytical check of the balance of non-controlling interests remains as a useful technique that can be applied using the latest ownership interest.