



Accounting and Reporting Policy

FRS 102

Staff Education Note 15

Acquisitions and disposals of subsidiaries

Disclaimer

This Education Note has been prepared by FRC staff for the convenience of users of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. It aims to illustrate certain requirements of FRS 102, but should not be relied upon as a definitive statement on the application of the standard. The illustrative material is not a substitute for reading the detailed requirements of FRS 102.

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Introduction

This Staff Education Note compares the accounting treatment for acquisitions and disposals of subsidiaries under current UK accounting standards:

- FRS 2 *Accounting for subsidiary undertakings*;
- FRS 6 *Acquisitions and mergers*; and
- FRS 10 *Goodwill and intangible assets*;

with the requirements of the following sections in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*:

- Section 9 *Consolidated and Separate Financial Statements*;
- Section 19 *Business Combinations and Goodwill*; and
- Section 22 *Liabilities and Equity*.

It covers the following acquisition and disposal scenarios:

- Acquisition – control achieved in stages;
- Acquisition – increasing a controlling interest in a subsidiary;
- Disposal – where control is lost; and
- Disposal – where control is retained.

The term 'non-controlling interest' is used throughout this Staff Education Note and is interchangeable with the term 'minority interest'.

This Staff Education Note is written to highlight key areas of consideration when transitioning to FRS 102 and is not designed to be exhaustive.

Acquisition of subsidiaries

Determination of control and acquisition date

Although articulated slightly differently, the determination of when control is achieved, and therefore the acquisition date, in most circumstances, is unlikely to be different between current UK standards and FRS 102 in practice.

Step acquisitions / Control achieved in stages

This scenario arises when an entity obtains control over another entity over a number of transactions. For example, Company A acquires 30% of Company B on 1 January 20X1, and then a further 40% on 1 January 20X2, resulting in a controlling shareholding of 70%.

In this scenario, there is no difference in the accounting treatment between current UK accounting standards and FRS 102. The identifiable net assets of Company B are included in the consolidation at the fair values on the date control is achieved (ie 1 January 20X2), rather than at the date of the earlier purchases. Prior to 1 January 20X2 Company B would be accounted for as an associate, assuming that the 30% holding gave Company A significant influence over Company B. Goodwill is also recognised at the date control is achieved and generally is calculated as the difference between:

- a) the aggregate fair value of consideration given at each acquisition stage (as determined in accordance with paragraph 19.11 of FRS 102); and
- b) the fair value of Company A's interest in the identifiable net assets of Company B at the date control is achieved.

This method agrees with paragraph 9 of Schedule 6 to the Regulations¹. However, in rare circumstances, where this method of calculation would fail to give a true and fair view, both current UK accounting standards and paragraph A4.21 of FRS 102 allow goodwill to be calculated as the sum of goodwill arising from each purchase of an interest in the subsidiary, adjusted as necessary for any subsequent impairment. The difference between the goodwill calculated using this method and the method above is recognised in reserves.

¹ The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)

Increasing a controlling interest in a subsidiary

This scenario arises where a parent increases its controlling holding in a subsidiary, for example from 70% to 80%.

| FRS 2 Accounting for subsidiary undertakings | FRS 102 |
|---|---|
| <p>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 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.</p> <p>(FRS 2 paragraph 51)</p> | <p>The identifiable assets and liabilities and a provision for contingent liabilities of the subsidiary shall not be revalued to fair value and no additional goodwill shall be recognised at the date the controlling interest is increased.</p> <p>(FRS 102 paragraph 9.19C)</p> <p>The transaction shall be accounted for as a transaction between equity holders and the resulting change in non-controlling interest shall be accounted for in accordance with paragraph 22.19</p> <p>(FRS 102 paragraph 9.19D)</p> <p>An entity shall treat changes in a parent's controlling interest in a subsidiary that do not result in a loss of control as transactions with equity holders in their capacity as equity holders. Accordingly, the carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to equity holders of the parent. An entity shall not recognise a gain or loss on these changes. Also, an entity shall not recognise any change in the carrying amounts of assets (including goodwill) or liabilities as a result of such transactions.</p> <p>(FRS 102 paragraph 22.19)</p> |

There is a significant change in accounting treatment in this situation. Currently under FRS 2, the net assets of the subsidiary are revalued to fair value at the date control is increased and goodwill is recognised at that date, whereas under FRS 102, the net assets are not revalued and no goodwill is recognised; instead the transaction is treated as a transaction with equity holders.

Example 1

Company A acquires 70% of Company B for CU120m on 1 January 20X1, when the fair value and book value of its net assets was CU90m. A year later, Company A acquires a further 10% of Company B for CU20m when the carrying amount of Company B's net assets were CU100m. The fair value of Company B's net assets at that time was CU170m.

FRS 2

1 Jan 20X1 – Acquisition

Control has been achieved. The identifiable net assets of the subsidiary are consolidated at fair value of CU90m. Goodwill is recognised as an asset at the date of acquisition amounting to CU57m:

| | CUm |
|---|------|
| Cost to acquire 70% holding | 120 |
| Company A's share of identifiable net assets acquired (70% x CU90m) | (63) |
| | 57 |
| Positive goodwill | 57 |

Non-controlling interest of CU27m (30% x CU90m) is also recognised.

31 Dec 20X1 – Year end

The increase in Company B's net assets is due to profits of CU10m (CU100m - CU90m) being made during the year 20X1. This profit is split CU7m (70% x CU10m) to the equity holders of Company A (the parent) and CU3m (30% x CU10m) to the non-controlling interest.

The non-controlling interest's share in Company B's net assets now totals CU30m (CU27m + CU3m)².

1 Jan 20X2 – Decrease in controlling interest

As a result of the acquisition of an additional 10% holding, Company A's controlling share increases from 70% to 80%, and the non-controlling interest's share falls from 30% to 20%.

The non-controlling interest's share in the net assets of Company B will decrease by CU10m ((30% – 20%) x CU100m) and will now total CU20m (CU30m - CU10m)³.

Company B's net assets are revalued to fair value of CU170m and an uplift of CU70m is recognised in the consolidation. This uplift is split CU56m (80% x CU70m) to the equity holders of Company A and CU14m (20% x CU70m) to the non-controlling interest.

Further, additional goodwill is recognised on this acquisition amounting to CU3m:

| | CUm |
|--|------|
| Cost to acquire additional 10% holding | 20 |
| Company A's share of identifiable net assets acquired (10% x CU170m) | (17) |
| | 3 |
| Positive goodwill | 3 |

² This is the same as taking the non-controlling interest's share of Company B's net assets at 31 December 20X1 ie 30% x CU100m.

³ This is the same as taking the new non-controlling interest's share of Company B's net assets at 1 January 20X2 ie 20% x CU100m.

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1 Jan 20X1 – Acquisition

Same as FRS 2.

31 Dec 20X1 – Year end

Same as FRS 2.

1 Jan 20X2 – Decrease in controlling interest

This acquisition is treated as a transaction between equity holders. As with FRS 2, the non-controlling interest's share in the net assets of Company B will decrease by CU10m ($(30\% - 20\%) \times \text{CU}100\text{m}$) and will now total CU20m ($\text{CU}30\text{m} - \text{CU}10\text{m}$).

Company B's net assets are not revalued and will remain at CU100m.

No additional goodwill is recognised.

Disposal of subsidiaries

Where control is lost

This scenario arises where either a parent disposes of all of its shares in its subsidiary, or a parent disposes of some of its shares such that it no longer has a controlling holding (for example from 80% down to 40%).

There is no difference in the accounting treatment between current UK accounting standards and FRS 102. The results of the subsidiary (ie its profit or loss) will be included in the consolidation up to the date of disposal, and a gain or loss on disposal should also be recognised. This gain or loss is calculated as the difference between the fair value of the consideration received and the proportion of the identifiable net assets (including goodwill) of the subsidiary disposed of.

Where control is retained

This scenario arises where a parent disposes of some of its shares such that it still has a controlling holding (for example from 80% down to 60%).

| FRS 2 Accounting for subsidiary undertakings | FRS 102 |
|---|--|
| <p>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.</p> <p>Where the undertaking remains a subsidiary undertaking after the disposal, the non-controlling interest in that subsidiary undertaking should be increased by the carrying amount of the net identifiable assets that are now attributable to the non-controlling 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 non-controlling interest.</p> <p>(FRS 2 paragraph 52)</p> | <p>Where a parent reduces its holding in a subsidiary and control is retained, it shall be accounted for as a transaction between equity holders and the resulting change in non-controlling interest shall be accounted for in accordance with paragraph 22.19. No gain or loss shall be recognised at the date of disposal.</p> <p>(FRS 102 paragraph 9.19A)</p> <p>An entity shall treat changes in a parent's controlling interest in a subsidiary that do not result in a loss of control as transactions with equity holders in their capacity as equity holders. Accordingly, the carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to equity holders of the parent. An entity shall not recognise a gain or loss on these changes. Also, an entity shall not recognise any change in the carrying amounts of assets (including goodwill) or liabilities as a result of such transactions.</p> <p>(FRS 102 paragraph 22.19)</p> |

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There is a significant change in accounting treatment in this situation. Currently under FRS 2, a gain or loss is recognised on the disposal and a proportion of goodwill written off, whereas under FRS 102, no gain or loss is recognised and goodwill is not adjusted; instead the transaction is treated as a transaction with equity holders.

Example 2

Company A disposed of a proportion of its shares in Company B on 31 December 20X1 for CU100m in cash, reducing its holding from 80% to 60%. The carrying amount of the identifiable net assets of Company B in the consolidated financial statements was CU200m at that date. The carrying amount of goodwill attributable to the acquisition of Company B was CU40m at the date of disposal.

FRS 2

A gain of CU50m is recognised on disposal in the consolidated financial statements:

| | CUm |
|---|-------|
| Proceeds received | 100 |
| Carrying amount of identifiable net assets (inc. goodwill) attributable to group after disposal (60% x CU200m) + (60/80 x CU40m) | 150 |
| | <hr/> |
| | 250 |
| Carrying amount of identifiable net assets (inc. goodwill) attributable to group before disposal (80% x CU200m) + CU40m | (200) |
| | <hr/> |
| Gain | 50 |
| | <hr/> |

The carrying amount of goodwill is reduced by CU10m ($20/80 \times \text{CU}40\text{m}$).

The non-controlling interest's share in the net assets of Company B will increase from 20% to 40%, ie it will increase from CU40m ($20\% \times \text{CU}200\text{m}$) to CU80m ($40\% \times \text{CU}200\text{m}$). No goodwill is attributable to the non-controlling interest.

FRS 102

No gain or loss is recognised on this disposal; instead it is treated as a transaction between equity holders.

As with FRS 2, the non-controlling interest will increase from 20% to 40%, ie it will increase from CU40m to CU80m.

The carrying amount of goodwill is not adjusted as a result of the disposal.