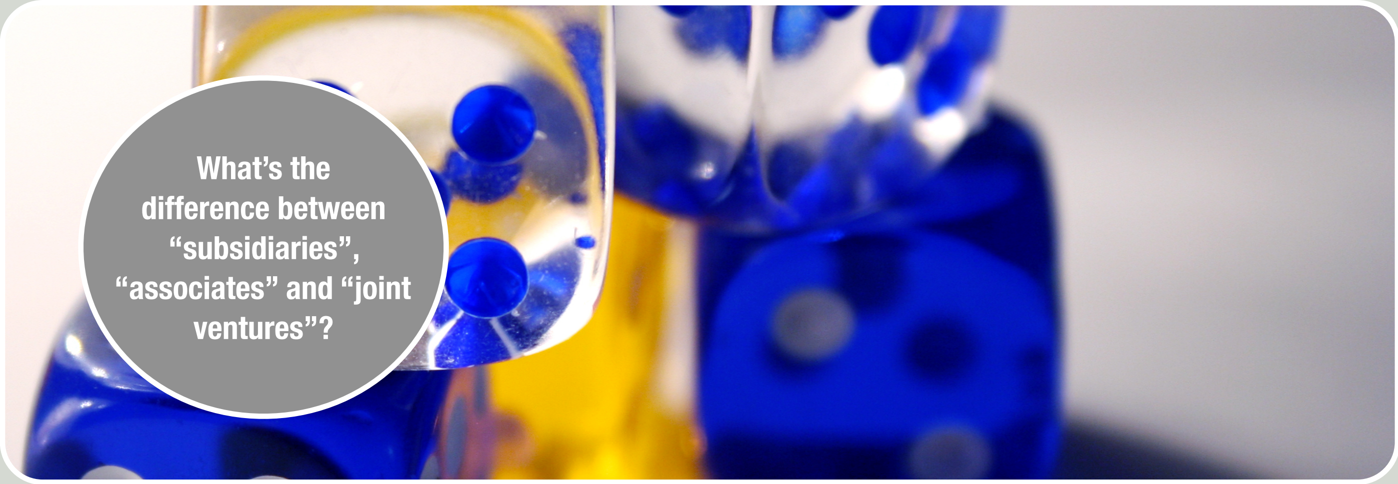
Sep 2010 VisionsOne Consulting

NEWSLETTER



UNDERSTANDING GROUP STRUCTURE IN FINANCIAL STATEMENTS

When you pick up an annual report, you would likely come across terms like "company" "subsidiaries", "associates" and "joint ventures". What do they mean, and how do they differ from each other?

Company

This refers to the investment holding company, also known as the parent.

The investment holding company owns shares in other companies, which may be its subsidiaries, associates or joint ventures.

Subsidiaries

Normally, when the investor company owns more than 50% of the shares of another company, it is presumed that a parent and subsidiary relationship exists.

This is confirmed if the investor company is able to exercise "control" over the investee company. For example, it may be able to appoint the majority of the board of directors.

As you can see, the parent does not have to own all the shares of the subsidiary for this to happen. Any of the shares not owned by the parent belongs to what is known as "minority shareholders" or "non-controlling interests"

The parent also does not need to own all the shares in the subsidiary directly to obtain control. For example, if the parent owns 51% of company A, which owns 100% of company B, it is deemed to be able to control company B through company A.

The parent and its subsidiaries comprise what is known as the group.

The accounts of the parent and its subsidiaries are combined and reported as a "consolidated" set of financial statements. It shows the combined activities of the parent and its subsidiaries as if it is one economic entity. This is done in view of their operational and financial inter-dependencies.

The accounting method used to

"COMPANY"

This refers to the investment holding company, also know as the parent.

Consolidation and Equity method

combine the accounts is called the "consolidation method", which adds the accounts of the parent and its subsidiaries on a line-by-line basis.

Associates

When the investor company owns between 20% to 50% of the shares of the investee company, the latter can be considered to be an "associate", especially if the investor company is able to exercise significant influence over the latter's operating and financial policies.

For example, this can be achieved if the shareholding gives the investor company the right to appoint a member of the board of directors. Regarding the accounting of its investment in an associate by the investor company, it uses what is called the "equity method" of accounting. This involves including in its own income statement, a percentage share of the associate's profit or loss, in a single line.

For example, if the investor company owns 20% of the associate, and the associate made $1 million of profit, the investor company would add $200,000 to its own income statement under a single line, "share of results of associate".

This is different from accounting for a subsidiary under the consolidation method, which includes adding the revenue, costs and expenses of the subsidiary to the parent's revenue, costs and expenses on a line-by-line basis.

Joint Ventures

By definition, a joint venture is a jointly-controlled entity. Thus it requires the unanimous consent of all the joint venture partners over the strategic decision of the entity.

Currently, an investor company can choose to use either the "equity method" as described above or the "proportionate consolidation method". The latter involves adding its proportionate share of the assets and liabilities in the joint venture entity to its own financial statements.

Subsidiaries:
Control (> 50%)

Associates: Significant influence (20% -50%)

Joint ventures:
Joint control

About the author

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