

## GENERAL ACCOUNTING

### SECTION 1601

#### consolidated financial statements

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#### PURPOSE AND SCOPE

- .01 This Section establishes standards for the preparation of consolidated financial statements. Five other Sections deal with closely related matters:
- (a) BUSINESS COMBINATIONS, Section 1582, deals with the accounting for business combinations. In particular, this Section addresses the determination of the carrying amount of the assets and liabilities of a subsidiary company, goodwill and accounting for a non-controlling interest at the time of the business combination.
  - (b) SUBSIDIARIES, Section 1591, deals with the circumstances in which consolidation is used in the general purpose financial statements of profit-oriented enterprises, and provides an accounting policy choice for an enterprise to either consolidate its subsidiaries or to account for them using the equity method or the cost method.
  - (c) NON-CONTROLLING INTERESTS, Section 1602, addresses accounting for non-controlling interests in consolidated financial statements subsequent to the business combination.

- (d) INVESTMENTS, Section 3051, deals with the circumstances in which the equity method of accounting is used.
  - (e) (deleted)
  - (f) GOODWILL AND INTANGIBLE ASSETS, Section 3064, addresses accounting for goodwill subsequent to a business combination.
- .02 This Section specifically discusses consolidation accounting following a business combination that involves a purchase of an equity interest by one company in another. The principles in this Section are also to be used as a general guide in situations involving a combination or consolidation other than through purchase of an equity interest or involving unincorporated businesses.
- .03 Consolidated financial statements are those produced by aggregating the financial statements of one or more subsidiary companies on a line-by-line basis (i.e., adding together corresponding items of assets, liabilities, revenues and expenses) with the financial statements of the parent company, eliminating intercompany balances and transactions and providing for any non-controlling interest in a subsidiary company (see NON-CONTROLLING INTERESTS, Section 1602). Consolidated financial statements recognize that the separate legal entities are components of one economic unit and are distinguishable from the separate parent and subsidiary company statements and from combined statements of affiliated companies. The distinction is based both on the nature of such statements and on the difference in circumstances justifying their use.

#### **COMBINED FINANCIAL STATEMENTS**

- .04 Combined financial statements (as distinguished from consolidated financial statements in that the financial statements of the parent company are not included) may be useful in certain circumstances although they are not a substitute for consolidated financial statements. Combined financial statements could be useful when one individual owns a controlling interest in several corporations. They could also be used to present the financial position and the results of operations of a group of subsidiaries, or to combine the financial statements of companies under common management.
- .05 When combined financial statements are prepared, similar principles to those used in preparing consolidated financial statements apply.

#### **PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS**

- .06 The accounting principles that apply to the preparation of consolidated financial statements can be presented in three segments:
- (a) those that apply to the initial preparation of consolidated financial statements at the date of an acquisition;
  - (b) those that apply to transactions reported in subsequent consolidated financial statements; and
  - (c) those that apply to miscellaneous transactions or relationships between the parent and subsidiary company.
- .06A *When an enterprise prepares consolidated financial statements, it shall describe those financial statements as being prepared on a consolidated basis and each statement shall be labelled accordingly.*

##### **At the date of acquisition**

- .07 When consolidated financial statements are prepared, the investment account of the parent is replaced by the identifiable assets and liabilities of the subsidiary, any non-controlling interest therein, and any goodwill arising as a result of the investment. Preparation of such financial statements requires that appropriate carrying amounts at the date of acquisition be determined for each asset and liability for the non-controlling interest and for goodwill (see BUSINESS COMBINATIONS, Section 1582, and NON-CONTROLLING INTERESTS, Section 1602).

##### **Intercompany balances**

- .08 Consolidated financial statements present two or more distinct legal entities as one single economic unit. To the extent that the two legal entities have receivables or payables from or to the other, such amounts must be eliminated upon consolidation.
- .09 *Intercompany balances shall be eliminated upon consolidation.*

##### **Consolidated retained earnings**

- .10 Since retained earnings represents the accumulation of undistributed earnings of a company, it would be inappropriate to include in consolidated retained earnings the undistributed earnings that existed in a subsidiary company at the date of its acquisition by the parent.
- .11 *The retained earnings or deficit of a subsidiary company at the date(s) of acquisition by the parent shall not be included in consolidated retained earnings.*
- .12 Sometimes the carrying amount of the assets of the parent company or the subsidiary company includes gains or losses arising from transactions between the two companies prior to the date of acquisition. Since transactions that took place prior to the date of acquisition are ordinarily assumed to have taken place at arm's length, the amounts involved in such transactions constitute objective evidence of value. Accordingly, such gains or losses are not eliminated in the preparation of consolidated financial statements.
- .13 *When the carrying amount of the assets of the parent company or a subsidiary company include gains or losses arising from intercompany transactions that took place prior to the date of acquisition, such gains or losses shall not be eliminated unless the transactions were made in contemplation of acquisition.*

#### **At dates subsequent to an acquisition**

- .14 Consolidated financial statements prepared on dates subsequent to the date of an acquisition are based on the amount assigned to assets, liabilities and non-controlling interest at the date of acquisition and, in addition, indicate the effects of transactions subsequent to that date.

#### **Normal operating transactions subsequent to an acquisition**

- .15 The existence of intercompany sales and purchases of goods and services, including inventory and fixed asset items, and intercompany lending and borrowing transactions will require the adjustment in the consolidated financial statements of the amounts included in the individual company financial statements.

#### **Intercompany gains and losses**

- .16 To the extent that assets transferred within the consolidated group are still on hand, their carrying amounts may include unrealized intercompany gains or losses. The amount of such gains or losses would include the gain or loss on disposal of fixed assets and the profit and loss on sale of inventory items. The existence of intercompany losses may indicate a decline in the value of the relevant assets. It may be necessary to recognize this decline in value by writing down such assets. In certain circumstances, some of the costs incurred in transferring assets within the consolidated group, such as freight costs, may appropriately increase the assets' carrying amount. Any income taxes paid or recovered by the transferor as a result of the transfer would be recognized as an asset or a liability in the consolidated financial statements until the gain or loss is recognized by the consolidated entity (see INCOME TAXES, paragraphs 3465.05-.07 and 3465.19-.50).
- .17 Complete elimination of unrealized intercompany gains or losses and adjustments of applicable income taxes is necessary on the basis that an entity cannot report gains or losses without validation from an external source. There is a view that, when a non-controlling interest exists, a proportion of any intercompany transaction may be considered to have been at arm's length, and that the proportion of the gains or losses relating to the non-controlling interest would be recognized in computing income. This view is inconsistent with the fact that the parent and its subsidiary are related and, therefore, are not operating at arm's length. For this reason, unrealized intercompany gains or losses are entirely eliminated.
- .18 When a parent or subsidiary manufactures or constructs facilities for a regulated public utility in the consolidated group, any intercompany gain or loss is deemed to have been realized to the extent that the transfer price on such facilities is recognized for rate-making purposes by a government regulatory body.
- .19 *Unrealized intercompany gains or losses arising subsequent to the date of an acquisition on assets remaining within the consolidated group shall be eliminated. The amount of elimination from assets shall not be affected by the existence of a non-controlling interest.*
- .20 When, since the date of acquisition, depreciable fixed assets have been transferred within the consolidated entity, the carrying amount of such assets may include unrealized intercompany gains or losses. As such fixed assets will be depreciated in the consolidated financial statements on the basis of their cost to the consolidated entity, a complete elimination of intercompany gains or losses will necessitate the adjustment of the portion of the depreciation charges attributable to such gains or losses.
- Depreciation and amortization**
- .21 The assets and liabilities of the subsidiary company that were consolidated at the date of acquisition are deemed to have been purchased by the consolidated entity on that date. The amounts determined at that date are the basis for subsequent accounting for these assets and liabilities (such as calculation of depreciation charges). Therefore, the sum of the depreciation charges in the parent and subsidiary company records may not equal the appropriate depreciation charge to be presented in the consolidated financial statements and adjustments may be necessary. Similarly, interest recognized on financial instruments measured at amortized cost may differ from the sum of interest amounts recorded by the parent and subsidiary.
- .22 *The depreciation, depletion and amortization of the assets of a subsidiary company shall be computed for the purposes of consolidated financial statements, on the basis of the amounts determined at the date of acquisition by the parent company.*
- Intercompany balances and transactions**
- .23 Intercompany transactions may involve items reported as revenue or expense in the income statements of the individual companies. Such transactions often result in the creation of intercompany receivable and payable balances. These assets, liabilities, revenues and expense amounts are eliminated in the preparation of consolidated financial statements.
- .24 *In consolidated financial statements prepared subsequent to the date of an acquisition, intercompany balances and post-acquisition transactions shall be eliminated.*
- Shareholders' equity transactions with interests outside the consolidated group**
- .25 Transactions subsequent to the date of acquisition may affect the proportional equity positions of the parent and the non-controlling interests. These include, for example, the sale by the parent company of some of its holdings in the subsidiary company, the issue by the subsidiary company of some of its own shares, and the repurchase by a subsidiary company of its own shares. Other equity transactions of the consolidated group with outside interests are similar in nature and may be accounted for accordingly.

- .26 When a parent company acquires additional shares in a subsidiary, that transaction will be accounted for in accordance with the guidelines provided in NON-CONTROLLING INTERESTS, paragraphs 1602.05-.06. Declaration of a stock dividend by a subsidiary company will also affect the number of shares held but not the relative positions of the parent and non-controlling interests.
- .27 When the parent company sells part of its shareholdings in a subsidiary company to outside interests, or the subsidiary company issues its own shares to outside interests, the shares sold or issued reduce the parent's interest and increase the non-controlling interest. Guidance on accounting for changes in an ownership interest in a subsidiary is provided in NON-CONTROLLING INTERESTS, paragraphs 1602.05-.12.  
Acquisition by a subsidiary of its own shares from interests outside the group
- .28 When a subsidiary acquires its own shares for cancellation from outside interests, the proportionate interest of the parent company after the transaction is increased. Since the transaction is similar in effect to the situation when the parent company acquires an additional interest in a subsidiary, it is accounted for in accordance with NON-CONTROLLING INTERESTS, paragraphs 1602.05-.06.
- .29 Any taxes related to the share acquisition transaction would be considered a part of the cost of shares acquired (see INCOME TAXES, paragraphs 3465.09 and 3465.59-.78).  
Stock dividends by subsidiary companies
- .30 The capitalization of retained earnings by a subsidiary company on the declaration of a stock dividend does not result in a change in the assets and liabilities of the parent's interest in the consolidated group.

### **Miscellaneous**

#### **Reciprocal shareholdings**

- .31 Reciprocal shareholdings are said to exist when a subsidiary company owns shares of the parent company or when a parent has more than one subsidiary and two or more of the subsidiaries own shares in each other. When reciprocal shareholdings among subsidiary companies are eliminated on consolidation, a difference may arise between the purchase price in the purchaser's financial records and the carrying amount on the issuing company's financial records. Any difference is eliminated on consolidation in order that the non-controlling interests in all affected subsidiary companies receive their proportionate share. Algebraic methods may be used in computing the allocation.
- .32 *A difference arising from the elimination of reciprocal shareholdings among companies in the consolidated group shall be allocated to parent and non-controlling interests on the basis of their proportionate shareholdings.*
- .33 Dividends received by the subsidiary company on any reciprocal shareholdings would be excluded from consolidated net income and offset against the amount of dividends distributed.

#### **Prospective consolidation**

- .33A Consolidation of a subsidiary commences at the date the parent acquires control and continues as long as control exists. Accordingly, a parent does not retroactively consolidate a subsidiary for periods prior to its acquisition of control.

#### **Statements at different dates**

- .34 A difference in fiscal periods of a parent and a subsidiary does not of itself justify the exclusion of the subsidiary from consolidation. Normally the subsidiary can prepare, for consolidation purposes, statements for a period that exactly or nearly coincides with the fiscal period of the parent.

#### **Cessation of consolidation**

- .34A When an enterprise ceases to meet the definition of a subsidiary, the former parent ceases to consolidate the enterprise from that time and determines whether it has:
- (a) an investment subject to significant influence accounted for in accordance with INVESTMENTS, Section 3051; or
  - (b) a financial asset accounted for in accordance with FINANCIAL INSTRUMENTS, Section 3856; or
  - (c) other rights and obligations accounted for in accordance with the applicable Section(s), such as a lease (see LEASES, Section 3065) or a financial liability (see FINANCIAL INSTRUMENTS, Section 3856).

Amounts reported on a consolidated basis for periods prior to the cessation of consolidation are not retroactively restated on a non-consolidated basis.

- .34B Subsequent to a decision to dispose of a subsidiary and prior to the disposal date, the provisions of DISPOSAL OF LONG-LIVED ASSETS AND DISCONTINUED OPERATIONS, Section 3475, apply to any business of the subsidiary that meets the criteria in that Section to be classified as held for sale. Application of the requirements of Section 3475 does not result in cessation of consolidation.

### **PRESENTATION OF CONSOLIDATED FINANCIAL STATEMENTS**

- .35 Consolidated financial statements adhere to the disclosure and presentation requirements for all financial statements. There are also certain disclosure requirements that are peculiar to consolidated financial statements.

#### **Reciprocal shareholdings**

- .36 When a subsidiary company holds shares in the parent company, such shares shall be presented on consolidation as if the parent company had purchased its own shares.

- .37 *When a subsidiary company holds shares of the parent company, the issued share capital of the parent shall be set out in full, with the cost of the shares held by the subsidiary shown as a deduction from shareholders' equity (see SHARE CAPITAL, Section 3240).*

**Income statement presentation in period of an acquisition or disposal**

- .38 Only post-acquisition and pre-disposal income of a subsidiary company is included in consolidated net income. The guidelines for determining the date of disposal may be inferred from the guidelines for determining the date of acquisition contained in BUSINESS COMBINATIONS, Section 1582.

**DISCLOSURE**

- .39 *When, for purposes of consolidation, it is not possible to use financial statements for a period that substantially coincides with that of the investor's financial statements, this fact, and the period covered by the financial statements used, shall be disclosed.*
- .40 *When the fiscal periods of a parent and a subsidiary, the investment in which is accounted for by the consolidation method, are not coterminous, events relating to, or transactions of, the subsidiary that have occurred during the intervening period that significantly affect the financial position or results of operations of the group shall be recorded or disclosed, as appropriate.*

**EFFECTIVE DATE AND TRANSITION**

- .41 Except as specified in paragraph 1601.42, this Section applies to annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted.
- .42 Amendments to paragraphs 1601.01(b), 1601.01(e) and 1601.17, issued in September 2014, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2016. Earlier application is permitted.

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