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Bachelor of Commerce (B2001) | Level 3 • Part B Major | Monash University

Advanced financial accounting

Course Code: ACC3100 • Module 1 Notes

Module 1: Advanced Group Accounting: Complex Consolidations, Indirect Ownership & Associates

1.1 Control, Consolidation Architecture & AASB 10 Foundations

Corporate groups dominate Australian capital markets. Entities listed on the Australian Securities Exchange (ASX) rarely operate as single legal corporations; instead, they conduct business through networks of wholly owned subsidiaries, partly owned operating companies, special purpose vehicles, associates, and joint arrangements. While each subsidiary maintains separate legal personality under the *Corporations Act 2001 (Cth)*, consolidated financial statements present the assets, liabilities, equity, income, expenses, and cash flows of the parent and its subsidiaries as those of a single economic entity.

Under Part 2M.3 of the *Corporations Act 2001 (Cth)*, disclosing entities, public companies, and large proprietary companies are generally required to prepare financial reports in compliance with Australian Accounting Standards issued by the Australian Accounting Standards Board (AASB). Where an entity is a parent, *AASB 10 Consolidated Financial Statements* mandates the preparation of consolidated financial statements unless narrow exemption criteria apply (for example, an intermediate parent wholly owned by another Australian reporting parent, or an investment entity required to measure subsidiaries at fair value through profit or loss). Certain wholly owned Australian subsidiaries may also obtain relief from preparing individual financial reports under *ASIC Corporations (Wholly-owned Companies) Instrument 2016/785* by entering into a Deed of Cross Guarantee with their parent.

The Three-Element Control Model

AASB 10 establishes a single, principles-based definition of control applicable to all investees, regardless of whether they are traditional voting-stock corporations or structured entities. Under paragraph 7 of *AASB 10*, an investor controls an investee if and only if the investor possesses all three of the following elements simultaneously:

- **Power over the investee:** The investor holds existing rights that give it the current ability to direct the relevant activities—namely, the activities that significantly affect the investee's returns (such as setting operating budgets, appointing key management personnel, approving capital expenditure, or managing credit risk).
- **Exposure, or rights, to variable returns:** The investor's returns from its involvement with the investee have the potential to vary as a result of the investee's performance. Variable returns may be positive, negative, or both, and extend beyond dividends to management fees, tax benefits, economies of scale, and residual liquidation rights.
- **Link between power and returns:** The investor has the ability to use its power over the investee to affect the amount of the investor's returns. This third element distinguishes a *principal* (who consolidates) from an *agent* acting on behalf of other investors (such as an external fund manager with narrow decision-making authority and low co-investment).

In assessing power, preparers must distinguish **substantive rights** from **protective rights**. Substantive rights confer the practical ability to direct relevant activities when decisions need to be made; potential voting rights (such as currently exercisable convertible notes or call options that are in-the-money) can contribute to power if substantive. Protective rights, by contrast, only protect the holder's interest without granting power over relevant activities—for example, a bank's veto right over asset sales exceeding A$10,000,000 under a lending covenant, or a non-controlling shareholder's right to block changes to the corporate constitution.

Control can also exist without holding a majority of voting shares—a situation termed *de facto control*. For instance, if an ASX-listed entity holds 42% of the voting shares of an investee while the remaining 58% is widely dispersed among thousands of retail shareholders who historically do not attend general meetings or coordinate votes, the 42% shareholder may exercise practical power over board elections and thus control the investee under *AASB 10*.

Acquisition Accounting, Goodwill & Consolidation Mechanics

When control is obtained through a business combination, *AASB 3 Business Combinations* requires application of the acquisition method at the acquisition date. Identifiable assets acquired and liabilities assumed—including previously unrecognised intangible assets such as brand names, customer contracts, and patents—are measured at acquisition-date fair value. Any difference between the carrying amount of an identifiable net asset in the subsidiary's own ledger and its acquisition-date fair value creates a **fair value adjustment (FVA)** on consolidation, accompanied by a deferred tax asset or deferred tax liability under *AASB 112 Income Taxes* (at Australia's corporate tax rate, typically 30% for large companies).

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AASB 3 permits two methods for measuring Non-Controlling Interest (NCI) at the acquisition date on a transaction-by-transaction basis:

1. **Partial Goodwill (Proportionate Share) Method:** NCI at acquisition date is measured at the NCI's proportionate share of the acquiree's identifiable net assets at fair value. Only the parent's share of goodwill is recognised.
2. **Full Goodwill (Fair Value) Method:** NCI at acquisition date is measured at fair value (for example, using quoted share prices of the remaining non-controlling shares or a valuation technique). Goodwill recognised equals total acquisition-date fair value of the business (consideration transferred plus fair value of NCI plus fair value of any previously held equity interest) minus identifiable net assets at fair value.

Under the partial goodwill method, goodwill recognised by the group is expressed mathematically as:

$$GW_{\text{partial}} = CT - \alpha \cdot INA_{\text{FV}}$$

Where:

- GW_{partial} = Goodwill attributable to the parent under the partial goodwill method (in AUD).
- CT = Fair value of consideration transferred by the parent at the acquisition date.
- α = Parent's direct ownership proportion in the subsidiary (expressed as a decimal, e.g., \$0.80\$).
- INA_{FV} = Fair value of the subsidiary's identifiable net assets at the acquisition date, calculated as recorded equity plus after-tax fair value adjustments.

Under the full goodwill method, total goodwill attributable to both parent and NCI is expressed as:

$$GW_{\text{full}} = CT + FV_{\text{NCI}} - INA_{\text{FV}}$$

Where:

- GW_{full} = Total consolidated goodwill under the full goodwill method (in AUD).
- CT = Fair value of consideration transferred by the parent.
- FV_{NCI} = Acquisition-date fair value of the non-controlling interest.
- INA_{FV} = Fair value of the subsidiary's identifiable net assets at the acquisition date.

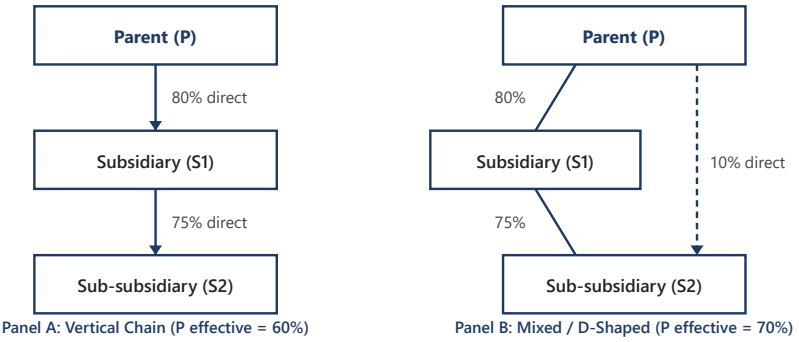
If $CT + FV_{\text{NCI}} < INA_{\text{FV}}$ (or $CT < \alpha \cdot INA_{\text{FV}}$ under partial goodwill), the transaction represents a **bargain purchase**. After reassessing all fair values, the acquirer recognises the resulting gain immediately in consolidated profit or loss at the acquisition date (attributed entirely to the parent, not to NCI).

Across subsequent reporting periods, consolidation worksheet entries perform four core functions: (1) recognising and amortising/depreciating acquisition-date fair value adjustments and associated deferred tax; (2) eliminating the parent's investment account against the subsidiary's pre-acquisition equity (the pre-acquisition entry); (3) eliminating 100% of intragroup transactions and unrealised profits on inventory, depreciable assets, and intragroup dividends/loans net of deferred tax; and (4) allocating post-acquisition equity movements and current-period profit or loss to the NCI.

1.2 Multi-Tier Corporate Groups & Indirect Ownership Structures

Modern Australian corporate groups frequently span multiple ownership tiers. A parent entity (P) may control a subsidiary (S_1), which in turn controls a sub-subsidiary (S_2). Alternatively, P may hold both an indirect interest in S_2 via S_1 and a direct minority shareholding in S_2. Accountants must determine whether P controls S_2, compute the effective economic interests of the parent and non-controlling shareholders, and execute consolidation entries without double-counting equity or misallocating pre-acquisition reserves.

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Determining Control vs Effective Economic Interest

A foundational principle of *AASB 10* is that **control is assessed via voting power along the chain, whereas profit and net asset attribution depends on effective economic ownership**. Suppose Parent P holds 60% of Subsidiary S_1, and S_1 holds 60% of Sub-subsidiary S_2. Does P control S_2? Yes: because P controls S_1, P directs how S_1 exercises its 60% majority voting block in S_2. Consequently, S_2 must be consolidated at 100% of its assets, liabilities, revenues, and expenses—even though P's effective economic ownership in S_2 is only $0.60 \times 0.60 = 36\%$, leaving a total NCI of 64%!

In a general mixed (D-shaped) structure where P owns fraction p_1 of S_1, P directly owns fraction p_2 of S_2, and S_1 owns fraction s_{12} of S_2, the effective parent ownership (E_P) and total NCI (NCI_{total}) in S_2 are defined by:

$$E_P(S_2) = p_2 + (p_1 \times s_{12})$$

$$NCI_{\text{total}}(S_2) = 1 - E_P(S_2) = (1 - p_2 - s_{12}) + (1 - p_1) \cdot s_{12}$$

Where:

- $E_P(S_2)$ = Parent's effective economic ownership proportion in sub-subsidiary S_2.
- p_1 = Direct ownership proportion of P in intermediate subsidiary S_1.
- p_2 = Direct ownership proportion of P in sub-subsidiary S_2 ($p_2 = 0$ in a pure vertical chain).
- s_{12} = Direct ownership proportion of S_1 in S_2.
- $DNCI(S_2) = 1 - p_2 - s_{12}$ = **Direct NCI** held by external shareholders who own shares directly in S_2.
- $INCI(S_2) = (1 - p_1) \cdot s_{12}$ = **Indirect NCI** held in S_2 via the external non-controlling shareholders of S_1.

Sequential vs Direct Consolidation & The Investment Deduction Rule

Two mathematically equivalent methods exist to consolidate multi-tier groups: the **sequential approach** (consolidating S_2 into S_1 first to produce sub-consolidated statements for S_1, then consolidating S_1 into P) and the **direct (single-stage) approach** (eliminating all investments simultaneously on one group worksheet). Australian university curricula emphasise the direct approach because it mirrors enterprise consolidation software and highlights the exact mechanics of Direct NCI and Indirect NCI.

Under the direct approach, a critical rule governs the calculation of Indirect NCI in S_2's pre-acquisition equity and S_1's investment in S_2. Because S_1's balance sheet carries an asset titled *Investment in* S_2, and S_1's external shareholders ($1 - p_1$) own a stake in S_1's net assets, allocating $(1 - p_1)$ of S_1's pre-acquisition equity to NCI while also allocating $INCI(S_2)$ of S_2's pre-acquisition equity to NCI would double-count the value of S_1's investment in S_2 unless eliminated. Specifically, in the NCI share of S_2's acquisition-date equity (and in the elimination of S_1's investment in S_2), the Indirect NCI's share of the cost of S_1's investment in S_2, namely $(1 - p_1) \times CT_{S_1 \to S_2}$, is deducted from NCI.

Equally important is the **sequence of acquisitions**:

- P **acquires** S_1 **before** S_1 **acquires** S_2**:** When S_1 later acquires S_2, the group's acquisition date for S_2 is the date S_1 obtains control of S_2. All of S_2's equity at that date is pre-acquisition to the group.

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- **S_1 acquires S_2 before P acquires S_1:** When P subsequently acquires S_1, P obtains control of the combined $S_1 + S_2$ subgroup on that later date. For the group, S_2's pre-acquisition equity is measured at the date P acquired S_1 (using S_2's fair values at that date), not the earlier date when S_1 bought S_2. Any post-acquisition profits earned by S_2 between S_1's purchase and P's purchase are pre-acquisition to P (though still shared with S_1's DNCI if S_1 had DNCI during that interval).

Worked Numerical Example 1: Vertical Chain Consolidation with Fair Value Adjustments & Intragroup Transactions

Scenario: On 1 July 2025, **Southern Cross Holdings Ltd (P)** acquired 80% of the issued shares of **Tasman Manufacturing Pty Ltd (S_1)** for A$4,800,000. On the same date, S_1 acquired 75% of the issued shares of **Bass Strait Logistics Pty Ltd (S_2)** for A$1,950,000. The group applies the partial goodwill method, and the Australian corporate tax rate is 30%.

At 1 July 2025, the recorded equity and fair value differentials of S_1 and S_2 were:

Component at 1 July 2025	Tasman Manufacturing (S_1)	Bass Strait Logistics (S_2)
Share Capital	A$3,000,000	A$1,200,000
Retained Earnings	A$1,800,000	A$800,000
Recorded Net Assets (Book Equity)	A$4,800,000	A$2,000,000
Fair Value Uplift on Plant (remaining life 5 years)	A$500,000 (carrying A$1,500,000; FV A$2,000,000)	A$200,000 (carrying A$600,000; FV A$800,000)
Deferred Tax Liability on FVA (30%)	(A$150,000)	(A$60,000)
Identifiable Net Assets at Fair Value (INA_{FV})	**A$5,150,000**	**A$2,140,000**

During the year ended 30 June 2026:

- Stand-alone net profits after tax: P = A$1,400,000; S_1 = A$700,000; S_2 = A$400,000.
- Intragroup dividends declared and paid in June 2026: S_2 paid A$100,000 total dividends (S_1 received 75% = A$75,000; DNCI received 25% = A$25,000); S_1 paid A$200,000 total dividends (P received 80% = A$160,000; DNCI received 20% = A$40,000).
- Intragroup inventory sale: S_2 sold inventory costing A$180,000 to S_1 for A$240,000 (unrealised profit in S_2 = A$60,000). At 30 June 2026, 50% of this inventory remains unsold in S_1's warehouse.

Step 1: Ownership Percentages & NCI Decomposition

- In S_1: Parent direct interest $p_1 = 80\%$; $DNCI(S_1) = 20\%$.
- In S_2: Parent effective interest $E_P(S_2) = 0.80 \times 0.75 = 60\%$.
- $DNCI(S_2) = 1 - 0.75 = 25\%$; $INCI(S_2) = 0.20 \times 0.75 = 15\%$; Total $NCI(S_2) = 25\% + 15\% = 40\%$.

Step 2: Acquisition Analysis & Goodwill (Partial Goodwill Method)

For S_1 (Parent's 80% share):

$$GW_{S_1} = 4,800,000 - (0.80 \times 5,150,000) = 4,800,000 - 4,120,000 = \text{AUD } 680,000$$

For S_2 (Note: only the parent's effective 60% share of S_2's goodwill is recognised under partial goodwill; S_1's 20% NCI share of S_2's goodwill is *not* recognised as group goodwill):

- Group share of S_1's investment cost in S_2 = $0.80 \times \text{AUD } 1,950,000 = \text{AUD } 1,560,000$.
- Group effective share of S_2's INA_{FV} = $0.60 \times \text{AUD } 2,140,000 = \text{AUD } 1,284,000$.
- Consolidated goodwill on S_2 = $\text{AUD } 1,560,000 - \text{AUD } 1,284,000 = \text{AUD } 276,000$.

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Notice the critical adjustment to S_1's DNCI at acquisition date: $DNCI(S_1)$ owns 20% of S_1's identifiable net assets at fair value ($0.20 \times \text{AUD } 5,150,000 = \text{AUD } 1,030,000$). However, S_1's assets include its A$1,950,000 investment in S_2, of which $20\% \times \text{AUD } 1,950,000 = \text{AUD } 390,000$ represents the $INCI(S_2)$ funding. Meanwhile, $NCI(S_2)$ (both DNCI 25% and INCI 15%, totalling 40%) is credited with 40% of S_2's INA_{FV} ($0.40 \times \text{AUD } 2,140,000 = \text{AUD } 856,000$). Deducting the A$390,000 indirect investment from NCI prevents double-counting S_1's investment in S_2. Thus, net NCI at acquisition date across the whole group equals:

$$\text{Total NCI}_{1\text{ Jul 2025}} = \text{AUD } 1,030,000 + \text{AUD } 856,000 - \text{AUD } 390,000 = \text{AUD } 1,496,000$$

Verification: Total Group INA_{FV} excluding intragroup investment = $\text{AUD } 5,150,000 + \text{AUD } 2,140,000 - \text{AUD } 1,950,000 = \text{AUD } 5,340,000$ (before goodwill) . To verify the consolidated balance sheet equation at 1 July 2025, note that S_1's recorded equity of A$4,800,000 already includes its A$1,950,000 cash/investment asset! When we consolidate, we eliminate the A$1,950,000 investment asset against S_2's equity. Let us verify the balance sheet equation at 1 July 2025: Parent paid A$4,800,000; S_1 net assets excluding investment in S_2 = $\text{AUD } 5,150,000 - \text{AUD } 1,950,000 = \text{AUD } 3,200,000$; S_2 net assets = A$2,140,000. Total external identifiable net assets of $S_1 + S_2$ = $\text{AUD } 3,200,000 + \text{AUD } 2,140,000 = \text{AUD } 5,340,000$. Group share of S_1 excluding investment = $80\% \times 3,200,000 = 2,560,000$; group share of S_2 = $60\% \times 2,140,000 = 1,284,000$; sum = $\text{AUD } 3,844,000$. Plus total goodwill ($\text{AUD } 680,000 + \text{AUD } 276,000 = \text{AUD } 956,000$) = $\text{AUD } 4,800,000$ (Parent's investment!). And external NCI share of $S_1 + S_2$ net assets = $(20\% \times 3,200,000) + (40\% \times 2,140,000) = \text{AUD } 640,000 + \text{AUD } 856,000 = \text{AUD } 1,496,000$. The check reconciles to the exact dollar!

Step 3: Consolidation Worksheet Entries at 30 June 2026

No.	Consolidation Journal Entry (30 June 2026)	Dr (A$)	Cr (A$)
1a	Dr Plant (S_1 FVA) / Cr Deferred Tax Liability / Cr Business Combination Valuation Reserve (S_1)	500,000	150,000 / 350,000
1b	Dr Depreciation Expense (S_1: 500,000 / 5) / Cr Accumulated Depreciation Dr Deferred Tax Liability / Cr Income Tax Expense (30% × 100,000)	100,000 30,000	100,000 30,000
2a	Dr Plant (S_2 FVA) / Cr Deferred Tax Liability / Cr Business Combination Valuation Reserve (S_2)	200,000	60,000 / 140,000
2b	Dr Depreciation Expense (S_2: 200,000 / 5) / Cr Accumulated Depreciation Dr Deferred Tax Liability / Cr Income Tax Expense (30% × 40,000)	40,000 12,000	40,000 12,000
3	**Pre-acquisition Elimination (S_1):** Dr Share Capital (S_1) / Dr Retained Earnings (S_1) / Dr BCVR (S_1) / Dr Goodwill (S_1) Cr Investment in S_1 (in P) / Cr NCI (20% × 5,150,000)	3,000,000 / 1,800,000 350,000 / 680,000	4,800,000 1,030,000
4	**Pre-acquisition Elimination (S_2):** Dr Share Capital (S_2) / Dr Retained Earnings (S_2) / Dr BCVR (S_2) / Dr Goodwill (S_2) Dr NCI (INCI deduction: 20% × 1,950,000) Cr Investment in S_2 (in S_1) / Cr NCI (40% × 2,140,000)	1,200,000 / 800,000 140,000 / 276,000 390,000	1,950,000 856,000
5	**Intragroup Inventory ($S_2 \rightarrow S_1$, 50% unsold = A$30,000 unrealised profit):** Dr Sales Revenue / Cr Cost of Goods Sold / Cr Inventory Dr Deferred Tax Asset / Cr Income Tax Expense (30% × 30,000)	240,000 9,000	210,000 / 30,000 9,000
6	**Intragroup Dividends:** Dr Dividend Revenue (in P, 80% of 200k) / Dr NCI (20% of 200k) / Cr Dividends Paid (S_1) Dr Dividend Revenue (in S_1, 75% of 100k) / Dr NCI (25% of 100k) / Cr Dividends Paid (S_2)	160,000 / 40,000 75,000 / 25,000	200,000 100,000

Step 4: Calculation of NCI Share of Consolidated Profit for FY2026

To prevent double-counting intragroup dividends, start with each subsidiary's stand-alone profit, deduct intragroup dividend income received from below, and adjust for after-tax FVA depreciation and unrealised profit recognised in that subsidiary:

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- **Adjusted Profit of S_2 (applicable to 40% total NCI):** Stand-alone profit A$400,000 – after-tax FVA depreciation A$28,000 ($40,000 \times 70\%$) – after-tax unrealised inventory profit in S_2 A$21,000 ($30,000 \times 70\%$) = **A$351,000**.
- **Adjusted Operating Profit of S_1 excluding dividend from S_2 (applicable to 20% DNCI of S_1):** Stand-alone profit A$700,000 – dividend received from S_2 A$75,000 – after-tax FVA depreciation A$70,000 ($100,000 \times 70\%$) = **A$555,000**.

Total NCI share of FY2026 Consolidated Profit:

$$NCI_{\text{Profit}} = (0.40 \times \text{AUD } 351,000) + (0.20 \times \text{AUD } 555,000) = \text{AUD } 140,400 + \text{AUD } 111,000 = \text{AUD } 251,400$$

Checking Parent's share of Consolidated Profit: P's standalone profit excluding S_1 dividend (A$1,400,000 – A$160,000 = A$1,240,000) + 80% × A$555,000 (A$444,000) + 60% × A$351,000 (A$210,600) = A$1,894,600. Total Consolidated Profit = A$1,894,600 + A$251,400 = A$2,146,000, which exactly equals standalone profits (A$1,400,000 + A$700,000 + A$400,000 = A$2,500,000) minus intragroup dividends (A$160,000 + A$75,000 = A$235,000) minus after-tax FVA depreciation (A$70,000 + A$28,000 = A$98,000) minus after-tax unrealised inventory profit (A$21,000) = A$2,146,000.

Step 5: Closing NCI Balance at 30 June 2026

Acquisition-date NCI ($\text{AUD } 1,496,000$) + NCI share of FY2026 profit ($\text{AUD } 251,400$) – dividends paid to external NCI ($\text{AUD } 40,000$ from S_1 + $\text{AUD } 25,000$ from S_2 = $\text{AUD } 65,000$) = **A$1,682,400**. Notice that the A$75,000 dividend paid by S_2 to S_1 stays inside the group and does not leave to external NCI; because it was deducted from S_1's profit above, no adjustment is omitted.

1.3 Changes in Ownership Interests: Step Acquisitions & Disposals

Ownership structures are rarely static. Groups routinely increase stakes in investees (step acquisitions) or divest shares (partial or complete disposals). Under *AASB 3* and *AASB 10*, the accounting treatment hinges entirely on whether the transaction crosses the threshold of control.

Step Acquisitions Achieving Control (*AASB 3.42*)

When an investor holds a non-controlling equity interest (for example, a 15% financial asset under *AASB 9* or a 30% associate under *AASB 128*) and subsequently acquires additional shares that confer control, the business combination is achieved in stages. At the acquisition date, the acquirer must:

1. Remeasure its **previously held equity interest (PHEI)** to acquisition-date fair value and recognise any resulting gain or loss in profit or loss (or OCI if the PHEI was an equity instrument irrevocably elected at FVOCI under *AASB 9*, in which case cumulative OCI is never recycled to P&L).
2. If the PHEI was previously an associate accounted for under the equity method, reclassify any share of the associate's OCI that would be reclassified on disposal (such as FCTR or cash flow hedge reserves) to profit or loss, as if the associate had been disposed of.
3. Compute goodwill using the sum of consideration transferred for the new tranche, the acquisition-date fair value of the PHEI, and the acquisition-date NCI, less the fair value of identifiable net assets.

Changes in Ownership Without Losing Control (*AASB 10.23*)

Once control exists, acquiring additional shares from NCI (e.g., increasing from 75% to 90%) or selling shares to NCI while retaining control (e.g., reducing from 80% to 60%) is accounted for strictly as an **equity transaction** between owners of the economic entity. No goodwill is remeasured, no fair value adjustments are re-calculated, and **no gain or loss is recognised in profit or loss**. Instead, the carrying amount of NCI is adjusted to reflect the change in its relative interest in the subsidiary's net assets (including any goodwill attributed to NCI under the full goodwill method), and any difference between the fair value of consideration paid or received and the adjustment to NCI is recognised directly in parent equity (typically in a reserve such as *Transactions with NCI Reserve*).

Let us illustrate with a concise calculation. Suppose Parent P holds 80% of Subsidiary S (partial goodwill method). At 30 June 2026, S's consolidated carrying amount of identifiable net assets is A$5,000,000, goodwill attributable to P is A$400,000, and NCI carries at $20\% \times \text{AUD } 5,000,000 = \text{AUD } 1,000,000$. On 1 July 2026, P sells a 20% stake in S for A$1,250,000 cash, reducing its ownership to 60% while retaining control. Because partial goodwill was used, NCI's share increases from 20% to

40% of S's identifiable net assets: NCI increases by $20\% \times \text{AUD } 5,000,000 = \text{AUD } 1,000,000$. The consolidation entry is: Dr Cash A$1,250,000 / Cr NCI A$1,000,000 / Cr Equity Reserve (Parent) A$250,000. Goodwill remains A$400,000 because the entity did not cross the control boundary.

Loss of Control (*AASB 10.25–26*)

When a parent loses control of a subsidiary (for instance, selling a 50% stake out of an 80% holding, leaving a 30% associate), the group ceases to consolidate the former subsidiary from the date control is lost. The parent must:

- Derecognise the carrying amounts of all assets (including goodwill), liabilities, and NCI of the former subsidiary.
- Recognise the fair value of any consideration received from the transaction.
- Recognise any retained investment in the former subsidiary at its **fair value at the date control is lost**, which becomes the initial cost for subsequent accounting under *AASB 128* (if significant influence remains) or *AASB 9*.
- Reclassify to profit or loss (or transfer directly to retained earnings if required, e.g., asset revaluation surplus) all amounts previously recognised in OCI in relation to that subsidiary (such as FCTR).
- Recognise the resulting net gain or loss on loss of control in consolidated profit or loss—noting that this gain or loss comprises both the realised gain on the shares sold and the unrealised remeasurement gain/loss on the retained stake.

Worked Numerical Example: Step Acquisition & Goodwill Impairment Under *AASB 136*

Scenario (Step Acquisition): On 1 July 2024, **Southern Cross Holdings Ltd** acquired a 15% equity interest in **Kangaroo Valley Dairy Ltd** for A$450,000 cash, classified as an investment at FVTPL under *AASB 9*. At 30 June 2025, the 15% stake was remeasured to its fair value of A$510,000 (recognising a A$60,000 gain in FY2025 P&L). On 1 January 2026, Southern Cross acquired an additional 60% of Kangaroo Valley Dairy's shares for A$2,160,000 cash, obtaining control (total holding 75%). At 1 January 2026, the fair value of the previously held 15% interest had risen to A$540,000, the fair value of Kangaroo Valley Dairy's identifiable net assets (INA_{FV}) was A$3,200,000, and the acquisition-date fair value of the remaining 25% NCI was A$860,000.

1. **Remeasurement of Previously Held Equity Interest (*AASB 3.42*):** On 1 January 2026, Southern Cross remeasures its 15% PHEI from A$510,000 to A$540,000, recognising a further gain of **A$30,000** in consolidated FY2026 profit or loss.
2. **Goodwill Under Partial Goodwill Method:**
   - NCI at acquisition = $25\% \times \text{AUD } 3,200,000 = \text{AUD } 800,000$.
   - Partial goodwill = A$2,160,000 (new 60%) + A$540,000 (PHEI 15%) + A$800,000 (NCI 25%) – A$3,200,000 = A$300,000 (equivalent to A$2,700,000 – 75% × A$3,200,000).
3. **Goodwill Under Full Goodwill Method:**
   - NCI at acquisition = $FV_{\text{NCI}} = \text{AUD } 860,000$.
   - Full goodwill = $\text{AUD } 2,160,000 + \text{AUD } 540,000 + \text{AUD } 860,000 - \text{AUD } 3,200,000 = \text{AUD } 360,000$ (comprising A$300,000 parent goodwill and A$60,000 NCI goodwill).

Impairment Testing of a CGU with Non-Controlling Interest (*AASB 136.C4*): Goodwill cannot generate cash flows independently and must be allocated to Cash-Generating Units (CGUs) for annual impairment testing under *AASB 136*. Because recoverable amount (higher of fair value less costs of disposal and value in use) reflects 100% of the CGU's cash flows—including those attributable to NCI—the carrying amount of a partly owned subsidiary CGU under the *partial goodwill method* must be notionally **grossed up** for unrecognised NCI goodwill before comparing against recoverable amount:

$$CA_{\text{adjusted}} = CA_{\text{identifiable}} + \frac{GW_{\text{partial}}}{\alpha}$$

Where:

- CA_{adjusted} = Notionally grossed-up carrying amount of the CGU compared against 100% recoverable amount (in AUD).
- $CA_{\text{identifiable}}$ = Carrying amount of the CGU's identifiable net assets (100%).
- GW_{partial} = Recognised parent goodwill allocated to the CGU; α = parent's ownership proportion.

Suppose at 30 June 2026 Kangaroo Valley Dairy's identifiable net assets carry at A$3,100,000 and the CGU's recoverable amount is A$3,320,000. Under the **partial goodwill method** ($\alpha = 75\%$), notional gross goodwill = $\text{AUD } 300,000/0.75 = \text{AUD } 400,000$ (implying A$100,000 unrecognised NCI goodwill). Adjusted carrying amount = $\text{AUD } 3,100,000 +$

$\text{AUD } 400,000 = \text{AUD } 3,500,000$, revealing a total notional impairment of $\text{AUD } 3,500,000 - \text{AUD } 3,320,000 = \text{AUD } 180,000$. Only the parent's 75% share of that impairment ($0.75 \times \text{AUD } 180,000 = \text{AUD } 135,000$) is recognised against parent goodwill (reducing recognised goodwill from A$300,000 to A$165,000, with zero impairment charged to NCI). By contrast, under the **full goodwill method**, carrying amount is $\text{AUD } 3,100,000 + \text{AUD } 360,000 = \text{AUD } 3,460,000$ (no gross-up required), total impairment is $\text{AUD } 3,460,000 - \text{AUD } 3,320,000 = \text{AUD } 140,000$, and the impairment is allocated to goodwill and shared between parent and NCI in proportion to their goodwill or ownership shares.

Intragroup Transfers of Depreciable Assets

Unlike inventory, which is ordinarily sold externally within one operating cycle, intragroup sales of property, plant and equipment create unrealised gains or losses that are realised gradually over the asset's remaining useful life as the purchasing group entity depreciates the inflated cost. Suppose Subsidiary S (80% owned) sells equipment with a carrying amount of A$120,000 to Parent P on 1 July 2025 for A$160,000 (an upstream pre-tax gain of A$40,000; remaining useful life 4 years; tax rate 30%). On consolidation at 30 June 2026, the worksheet entries: (1) eliminate the A$40,000 unrealised gain and reset Equipment to A$120,000, recognising a Deferred Tax Asset of A$12,000 ($30\% \times 40,000$); and (2) reverse one year of excess depreciation of $\text{AUD } 40,000/4 = \text{AUD } 10,000$ (Dr Accumulated Depreciation A$10,000 / Cr Depreciation Expense A$10,000) and reverse A$3,000 of the DTA (Dr Income Tax Expense A$3,000 / Cr Deferred Tax Asset A$3,000). Because the sale was upstream from S to P, the net after-tax unrealised profit remaining at 30 June 2026 ($\text{AUD } 28,000 - \text{AUD } 7,000 = \text{AUD } 21,000$) reduces S's adjusted profit when computing NCI's 20% share.

1.4 Associates, Significant Influence & Equity Accounting (*AASB 128*)

Where an investor does not control an investee but exercises **significant influence**—defined in *AASB 128 Investments in Associates and Joint Ventures* as the power to participate in the financial and operating policy decisions of the investee without control or joint control—the investee is classified as an **associate**.

Paragraph 5 of *AASB 128* establishes a quantitative presumption: holding 20% or more of the voting power (directly or through subsidiaries) indicates significant influence unless clearly demonstrated otherwise; holding less than 20% indicates an absence of significant influence unless clearly demonstrated. Qualitative indicators under paragraph 6 include: representation on the board of directors, participation in policy-making processes (including dividend decisions), material transactions between investor and investee, interchange of managerial personnel, and provision of essential technical information. Potential voting rights that are currently exercisable or convertible must also be considered when assessing the 20% threshold, though equity-method profit shares are based solely on present ownership interests.

Mechanics of the Equity Method

Often described as "one-line consolidation", the equity method initially records the investment at cost. Unlike *AASB 3* consolidations, any excess of cost over the investor's share of the net fair value of the associate's identifiable assets and liabilities—referred to as **notional goodwill**—is *not* separately recognised on the balance sheet; it remains embedded within the carrying amount of the *Investment in Associate* asset and is not amortised. Conversely, any excess of the investor's share of net fair value over cost (a bargain purchase) is included as income in determining the investor's share of the associate's profit or loss in the acquisition period.

After acquisition, the carrying amount of the investment is adjusted each period as follows:

$$IA_t = IA_{t-1} + \beta \cdot (NP_{\text{assoc},t} \pm \Delta FVA_{\text{post-tax}} \pm UP_{\text{net}}) + \beta \cdot OCI_{\text{assoc},t} - \beta \cdot Div_{\text{assoc},t}$$

Where:

- IA_t = Carrying amount of the Investment in Associate at the end of period t.
- β = Investor's present ownership proportion in the associate.
- $NP_{\text{assoc},t}$ = Associate's reported profit or loss for period t.
- $\Delta FVA_{\text{post-tax}}$ = Post-tax depreciation, amortisation, or cost of sales adjustments relating to acquisition-date fair value differentials on the associate's identifiable assets and liabilities.
- UP_{net} = Net after-tax elimination of unrealised profits (deducted) and realisation of prior-period unrealised profits (added) on upstream and downstream transactions between the investor (including its consolidated subsidiaries) and the associate.

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- $OCI_{\text{assoc},t}$ = Associate's other comprehensive income (e.g., land revaluation under *AASB 116* or FX translation differences), recognised in the investor's OCI.
- $Div_{\text{assoc},t}$ = Dividends declared/paid by the associate, which reduce the investment carrying amount rather than being recorded as dividend revenue in consolidated profit or loss.

Two special rules apply under *AASB 128*. First, for **upstream and downstream transactions** (inventory or depreciable assets sold between the group and the associate), unrealised profits and losses are eliminated only to the extent of the investor's interest (β), unlike subsidiary consolidations where 100% is eliminated. Second, if an associate incurs cumulative losses that reduce the carrying amount of the investment (together with any long-term interests forming part of the net investment) to zero, the investor discontinues recognising further losses unless it has incurred legal or constructive obligations or made payments on behalf of the associate (*AASB 128.38–39*). For impairment, the entire carrying amount of the investment (including embedded notional goodwill) is tested as a single asset under *AASB 136 Impairment of Assets* whenever objective evidence of impairment exists under *AASB 128.40–43*.

Worked Numerical Example 2: Equity Accounting Under AASB 128

Scenario: On 1 July 2025, **Melbourne Retail Group Ltd** (a parent entity preparing consolidated financial statements) acquired 30% of the ordinary shares of **Yarra Valley Foods Pty Ltd** for A$950,000 cash. At 1 July 2025, Yarra Valley Foods' recorded equity comprised Share Capital of A$2,000,000 and Retained Earnings of A$600,000 (total A$2,600,000). All identifiable assets and liabilities were at fair value except a specialised bottling machine whose fair value exceeded its carrying amount by A$200,000 (remaining useful life 4 years, straight-line). The corporate tax rate is 30%.

During the year ended 30 June 2026:

- Yarra Valley Foods reported net profit after tax of A$450,000 and recognised a land revaluation surplus (net of tax) in OCI of A$80,000.
- Yarra Valley Foods declared and paid a cash dividend of A$120,000 in May 2026.
- In March 2026, Melbourne Retail Group sold inventory costing A$100,000 downstream to Yarra Valley Foods for A$150,000 (unrealised profit A$50,000). By 30 June 2026, 40% of this inventory remained unsold by Yarra Valley Foods.

Step 1: Acquisition-Date Fair Value & Notional Goodwill Check

- After-tax FVA on bottling machine = $\text{AUD } 200,000 \times (1 - 0.30) = \text{AUD } 140,000$.
- Associate's INA_{FV} = $\text{AUD } 2,600,000 + \text{AUD } 140,000 = \text{AUD } 2,740,000$.
- Melbourne Retail's 30% share of INA_{FV} = $0.30 \times \text{AUD } 2,740,000 = \text{AUD } 822,000$.
- Embedded notional goodwill = $\text{AUD } 950,000 - \text{AUD } 822,000 = \text{AUD } 128,000$ (not recorded separately).

Step 2: Adjusted Associate Profit & Investor Share

- Annual additional depreciation on bottling machine = $\text{AUD } 200,000/4 = \text{AUD } 50,000$ pre-tax; after 30% tax = $\text{AUD } 35,000$.
- Unrealised profit in ending inventory = $40\% \times (\text{AUD } 150,000 - \text{AUD } 100,000) = \text{AUD } 20,000$ pre-tax; after 30% tax = $\text{AUD } 14,000$.
- Adjusted profit of Yarra Valley Foods = $\text{AUD } 450,000 - \text{AUD } 35,000 - \text{AUD } 14,000 = \text{AUD } 401,000$.
- Melbourne Retail's 30% share of profit = $0.30 \times \text{AUD } 401,000 = \text{AUD } 120,300$.
- Melbourne Retail's 30% share of OCI = $0.30 \times \text{AUD } 80,000 = \text{AUD } 24,000$.
- Melbourne Retail's 30% share of dividend = $0.30 \times \text{AUD } 120,000 = \text{AUD } 36,000$.

Step 3: Equity Accounting Entries on Consolidation Worksheet (30 June 2026)

Note that in its separate parent ledger, Melbourne Retail recorded Dr Cash A$36,000 / Cr Dividend Revenue A$36,000 upon receiving the dividend. On the consolidation worksheet, dividend revenue is reversed and the equity-accounted adjustments are posted:

Consolidation Worksheet Entry (30 June 2026)	Dr (A$)	Cr (A$)
Dr Dividend Revenue (reversing standalone dividend income) Cr Investment in Associate (Yarra Valley Foods)	36,000	36,000

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Consolidation Worksheet Entry (30 June 2026)	Dr (A$)	Cr (A$)
Dr Investment in Associate (Yarra Valley Foods)	144,300	
Cr Share of Profit of Associate (P&L)		120,300
Cr Share of OCI of Associate (Land Revaluation Reserve)		24,000

Closing carrying amount of Investment in Associate at 30 June 2026 = $\text{AUD } 950,000 - \text{AUD } 36,000 + \text{AUD } 120,300 + \text{AUD } 24,000 = \text{AUD } 1,058,300$.

1.5 Joint Arrangements (*AASB 11*)

Resource, infrastructure, and property development projects in Australia frequently operate through joint arrangements where two or more venturers share strategic control. *AASB 11 Joint Arrangements* governs entities subject to **joint control**, defined as the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the **unanimous consent** of the parties sharing control.

Unanimous consent means no single party can direct the relevant activities unilaterally, and any party with joint control can prevent any other party from making unilateral decisions. If three parties each hold 33.3% of a venture and decisions require a 75% supermajority, multiple combinations of two parties could reach 75%—no fixed group of parties must unanimously agree unless the contract specifies which parties constitute collective control, so joint control does *not* exist unless contractual clauses identify the exact controlling coalition.

Classifying Joint Operations vs Joint Ventures

AASB 11 classifies all joint arrangements into one of two categories based on the substance of the parties' rights and obligations:

1. **Joint Operation (JO):** The parties with joint control (*joint operators*) have rights to the assets, and obligations for the liabilities, relating to the arrangement. Each joint operator accounts for its share of assets, liabilities, revenues, and expenses line-by-line in its own financial statements (whether standalone or consolidated).
2. **Joint Venture (JV):** The parties with joint control (*joint venturers*) have rights to the net assets of the arrangement. Each joint venturer accounts for its interest as an investment using the **equity method** under *AASB 128* (proportionate consolidation is prohibited for joint ventures).

The classification decision follows a strict three-step assessment under *AASB 11.B12–B33*:

- **Step 1 — Structure of the Arrangement:** Is it structured through a *separate vehicle* (such as an incorporated proprietary company or trust)? If *not* structured through a separate vehicle (e.g., an unincorporated Pilbara iron ore mining syndicate), it is automatically a **Joint Operation**.
- **Step 2 — Legal Form and Contractual Terms:** If structured through a separate vehicle, does the legal form confer separation between the parties and the vehicle (as a company does)? If yes, examine whether contractual side-agreements modify the legal form to grant the parties direct rights to assets and obligations for liabilities.
- **Step 3 — Other Facts and Circumstances:** Even where a separate incorporated company exists and no explicit debt guarantee is written, if the arrangement's design restricts all output solely to the joint operators at a cost-recovery price—meaning the vehicle depends entirely on the parties for cash flows to settle its liabilities—then "other facts and circumstances" classify it as a **Joint Operation**.

Comparative Summary of Group Accounting Standards

Criterion	Subsidiary (*AASB 10*)	Joint Operation (*AASB 11*)	Joint Venture (*AASB 11 / 128*)	Associate (*AASB 128*)
Nature of Relationship	Control (power + variable returns + link)	Joint control (unanimous consent); rights to assets & obligations for liabilities	Joint control (unanimous consent); rights to net assets	Significant influence (power to participate, typically ≥ 20% voting)
Accounting Method	Full Consolidation (100% line-by-line + NCI)	Line-by-line recognition of operator's share of assets, liabilities, revenue, expenses	Equity Method (one-line investment; share of net profit & OCI)	Equity Method (one-line investment; share of net profit & OCI)

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Criterion	Subsidiary (*AASB 10*)	Joint Operation (*AASB 11*)	Joint Venture (*AASB 11 / 128*)	Associate (*AASB 128*)
Goodwill Treatment	Recognised separately (partial or full method); annual impairment test	Recognised separately if arrangement constitutes a business under *AASB 3*	Embedded as notional goodwill inside investment carrying amount	Embedded as notional goodwill inside investment carrying amount
Intragroup Profit Elimination	100% eliminated (adjusted against parent or NCI depending on direction)	Operator eliminates its own share of unrealised gains/losses on transactions with JO	Eliminated only to the extent of venturer's ownership interest	Eliminated only to the extent of investor's ownership interest
Disclosures	*AASB 12* (material NCI, group composition, restrictions, risks)	*AASB 12* (name, principal place of business, ownership %)	*AASB 12* (summarised financial information for material JVs, commitments)	*AASB 12* (summarised financial information, unrecognised losses, fair value if quoted)

Across all group reporting structures, *AASB 12 Disclosure of Interests in Other Entities* complements recognition and measurement by requiring transparent disclosure of significant judgements made in determining control, joint control, or significant influence, alongside summarised financial data for subsidiaries with material NCI and individually material associates or joint ventures.

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