

When is a company or a group of companies required to compile consolidated financial statements?



Consolidated financial statements are statements in which the operations of a holding entity with subsidiaries should be reflected as those of a single entity.

A “holding company” is defined in section 1 of the Companies Act 71 of 2008 as follows: “in relation to a subsidiary, [means] a juristic person or undertaking that controls that subsidiary”.

Section 3 of the Companies Act provides a definition of such control and regulates voting rights in respect of holding/subsidiary entities.

In a previous blog we discussed *the requirements for annual financial statements to be independently audited*, in this blog we focus on the requirements for consolidated financial statements and the relevant elements in this regard.

When are consolidated financial statements required?

In terms of section 3 of the Companies Act, control implies that the holding company, directly or indirectly, owns more than fifty percent of the voting shares (rights) of another company.

With regard to a holding company, control can be summarised as follows:

- A holding company has the power to appoint or dismiss a majority of the board of directors only if such directors control the company; or
- A holding company has the power to cast the majority vote at board meetings, while control rests with the board.

A subsidiary does not necessarily have to be a company. A company may not be a member of a Close Corporation (section 29 of the Close Corporations Act); thus, a Close Corporation may not be a subsidiary in a group structure but may be a holding entity. However, entities such as partnerships can be classified as subsidiaries. It is also possible for a Trust or a *Non-Profit Company* to hold the majority shares and, consequently, constitute a holding/subsidiary relationship.

The parent (holding) company is obliged to prepare separate as well as consolidated financial statements for the whole group.

Understanding voting rights and potential voting rights

The existence and effect of voting rights that are presently exercisable and convertible should be considered when assessing the degree of influence pertaining to financial and operating decisions. This principle also applies to associates in assessing the degree of material influence. Voting rights are not only attributed to shareholders in a conventional sense but also to those holding equity instruments (see definition of “securities” in section 1 of the Companies Act) with voting rights.

Voting rights may therefore arise by virtue of equity instruments such as–

- stock guarantees
- share options
- debt or equity instruments that are convertible into ordinary shares.

Potential voting rights are not considered until the date on which the rights in question are legally exercisable and convertible.

What are the different reporting dates?

A subsidiary usually changes its financial year-end at the time of acquisition in line with the year-end of the holding company.

What is meant with 'disclosure' in consolidated financial statements?

The following must be disclosed in consolidated financial statements:

- The extent of restriction of a subsidiary to pay dividends;
- All significant investments in subsidiaries, joint ventures and associates, as well as the methods by which such investments are accounted for;
- A schedule indicating the effect of the change in the holding company's interest in the subsidiary that does not give rise to a loss in control by the holding company.

What are the exceptions for not preparing consolidated financial statements?

The holding company does not have to prepare consolidated financial statements if-

- the holding company is a wholly owned subsidiary, or if the holding company is a non-wholly-owned subsidiary of another entity whose owners (including those not entitled to vote) have no objection if the holding company does not prepare consolidated financial statements;
- the debt or equity instrument is not publicly traded;
- the holding company did not offer its shares to the public.

Conclusion

Any entity that owns more than 50% of the voting shares in another company is considered a holding entity and must compile consolidated financial statements in accordance with International Accounting Standard 27 unless the holding company complies with the exceptions to the reporting standard.

SERR Synergy assists businesses to comply with the new Companies Act and amended Close Corporations Act by bringing all relevant company documents in line with new legislation.

Sources:

Notes on Group Financial Statements – 14th Edition (Translated)

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