

**SSAP 32**  
**STATEMENT OF STANDARD ACCOUNTING PRACTICE 32**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**AND ACCOUNTING FOR INVESTMENTS IN SUBSIDIARIES**

*(Issued January 2001)*

*The standards, which have been set in **bold italic type**, should be read in the context of the background material and implementation guidance and in the context of the Foreword to Statements of Standard Accounting Practice, Interpretations and Accounting Guidelines. Statements of Standard Accounting Practice are not intended to apply to immaterial items (see paragraph 8 of the Foreword).*

### **Scope**

1. ***This Statement should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.***
2. ***This Statement should also be applied in accounting for investments in subsidiaries in a parent's separate financial statements.***
3. This Statement defines a subsidiary as "an enterprise which is controlled by another enterprise". For this purpose, control is defined as the power to govern the financial and operating policies of another enterprise so as to obtain benefits from its activities. This definition of subsidiary could result in an investee enterprise being classified as a subsidiary when it does not meet the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance.
4. In issuing this Statement, the Hong Kong Society of Accountants has obtained legal advice on the legality of introducing a requirement in this Statement to consolidate certain entities which are not subsidiaries as defined by section 2(4) of the Companies Ordinance in group accounts of a Hong Kong incorporated company. The legal opinion states that the definitions of "subsidiary" and "holding company" in sections 2(4) and 2(7) of the Companies Ordinance are exhaustive for the purposes of group accounts as defined by section 124(1) of the Companies Ordinance. Accordingly, a Hong Kong incorporated company may not consolidate a company that does not meet the definition of a subsidiary in the Companies Ordinance.
5. The principles laid down in this Statement are applicable to Hong Kong incorporated companies except to the extent that the legal constraints do not permit them to include in their consolidated financial statements an entity which does not meet the definition of a subsidiary in the Companies Ordinance. However, this Statement requires Hong Kong incorporated companies to disclose certain additional information to enable users of the consolidated financial statements to assess the effects as if this Statement had been fully complied with.
6. Consolidated financial statements are encompassed by the term "financial statements" included in the Foreword to Statements of Standard Accounting Practice, Interpretations and Accounting Guidelines. Therefore, consolidated financial statements are prepared in accordance with Statements of Standard Accounting Practice.
7. This Statement does not deal with:
  - a. methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see SSAP 30 "Business combinations");
  - b. accounting for investments in associates (see SSAP 10 "Accounting for investments in associates"); and

- c. accounting for investments in joint ventures (see SSAP 21 "Accounting for interests in joint ventures").

## Definitions

8. *The following terms are used in this Statement with the meanings specified:*

***Control*** (for the purpose of this Statement) is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

***A subsidiary*** is an enterprise that is controlled by another enterprise (known as the parent).

***A parent*** is an enterprise that has one or more subsidiaries.

***A group*** is a parent and all its subsidiaries.

***Consolidated financial statements*** are the financial statements of a group presented as those of a single enterprise.

***Minority interest*** is that part of the net results of operations and of net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiaries, by the parent.

## Presentation of consolidated financial statements

9. *A parent, other than a parent described in paragraph 10, should present consolidated financial statements.*
10. *A parent that is a wholly-owned subsidiary need not present consolidated financial statements. Such a parent should disclose the reasons why consolidated financial statements have not been presented together with the bases on which subsidiaries are accounted for in its separate financial statements. The name and registered office of its parent that publishes consolidated financial statements should also be disclosed.*
11. Users of the financial statements of a parent are usually concerned with, and need to be informed about, the financial position, results of operations and cash flows of the group as a whole. This need is served by consolidated financial statements, which present financial information about the group as that of a single enterprise without regard for the legal boundaries of the separate legal entities.
12. A parent that is itself wholly owned by another enterprise may not always present consolidated financial statements since such statements may not be required by its parent and the needs of other users may be best served by the consolidated financial statements of its parent.

## Scope of consolidated financial statements

13. ***A parent which issues consolidated financial statements should consolidate all subsidiaries, foreign and domestic, other than those referred to in paragraph 23.***
14. The consolidated financial statements include all enterprises that are controlled by the parent, other than those subsidiaries excluded for the reasons set out in paragraph 23. Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than one half of the voting power of an enterprise unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Control also exists even when the parent owns one half or less of the voting power of an enterprise when there is:
- power over more than one half of the voting rights by virtue of an agreement with other investors;
  - power to govern the financial and operating policies of the enterprise under a statute or an agreement;
  - power to appoint or remove the majority of the members of the board of directors or equivalent governing body; or
  - power to cast the majority of votes at meetings of the board of directors or equivalent governing body.
15. In relation to paragraph 14(b), where there is an arrangement for joint control under an agreement which provides that no single party is in a position to control unilaterally the activity of the investee enterprise, such investee enterprise is to be accounted for as a jointly controlled entity in accordance with SSAP 21 "Accounting for interests in joint ventures" instead of as a subsidiary. For example, this may be the case where the agreement identifies those decisions in areas essential to the goals of the investee enterprise which require the consent of all the shareholders or a specified majority of the shareholders.
16. ***An entity should be consolidated when the substance of the relationship between an enterprise and the entity indicates that the entity is controlled by that enterprise.***
17. An entity may be created to accomplish a narrow and well-defined objective (e.g., to effect a lease, research and development activities or a securitisation of financial assets). Such a special purpose entity ("SPE") may take the form of a corporation, trust, partnership or unincorporated entity. SPEs often are created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of their governing board, trustee or management over the operations of the SPE. Frequently, these provisions specify that the policy guiding the ongoing activities of the SPE cannot be modified, other than perhaps by its creator or sponsor (i.e., they operate on so-called "autopilot").
18. The sponsor (or enterprise on whose behalf the SPE was created) frequently transfers assets to the SPE, obtains the right to use assets held by the SPE or performs services for the SPE, while other parties ("capital providers") may provide the funding to the SPE. An enterprise that engages in transactions with an SPE (frequently the creator or sponsor) may in substance control the SPE.
19. A beneficial interest in an SPE may, for example, take the form of a debt instrument, an equity instrument, a participation right, a residual interest or a lease. Some beneficial interests may simply provide the holder with a fixed or stated rate of return, while others give the holder rights or access to other future economic benefits of the SPE's activities. In most cases, the creator or sponsor (or the enterprise on whose behalf the SPE was created) retains a significant beneficial interest in the SPE's activities, even though it may own little or none of the SPE's equity.

20. In the context of an SPE, control may arise through the predetermination of the activities of the SPE (operating on "autopilot") or otherwise. Paragraph 14 of this Statement indicates several circumstances which result in control even in cases where an enterprise owns one half or less of the voting power of another enterprise. Similarly, control may exist even in cases where an enterprise owns little or none of the SPE's equity. The application of the control concept requires, in each case, judgement in the context of all relevant factors.
21. In addition to the situations described in paragraph 14, the following circumstances, for example, may indicate a relationship in which an enterprise controls an SPE and consequently would need to consolidate the SPE (additional guidance is provided in the Appendix to this Statement):
- a. in substance, the activities of the SPE are being conducted on behalf of the enterprise according to its specific business needs so that the enterprise obtains benefits from the SPE's operation;
  - b. in substance, the enterprise has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an "autopilot" mechanism, the enterprise has delegated these decision-making powers;
  - c. in substance, the enterprise has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or
  - d. in substance, the enterprise retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.
22. Predetermination of the ongoing activities of an SPE by an enterprise (the sponsor or other party with a beneficial interest) would not represent the type of restrictions referred to in paragraph 23(b).
23. ***A subsidiary should be excluded from consolidation when:***
- a. ***control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or***
  - b. ***it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.***
- Such subsidiaries should be accounted for as if they are investments other than held-to-maturity securities in accordance with SSAP 24 "Accounting for investments in securities".***
24. To classify an investment as having been acquired and held exclusively with a view to its subsequent disposal in the near future, the investor should expect that disposal will take place within one year of the date of acquisition. If the disposal has not been achieved by the end of the first annual accounting period commencing after the acquisition, the treatment may be continued only if the holding company has identified or is continuing to actively seek a purchaser and the extended period can be justified on the basis of particular circumstances of the subsidiary and the prevailing economic environment. In such a case, the disclosure of the reasons for not consolidating a subsidiary under the requirement of paragraph 45(b)(ii) of this Statement would normally include the disclosure of the particular circumstances and the company's plans in respect of the subsidiary.
25. The exemption granted under paragraph 23a would only be applied where the intention to dispose of the subsidiary is established at the time of acquisition. It cannot be used to justify the exclusion of a subsidiary that the parent has previously consolidated. In the circumstances of a disposal of a previously consolidated subsidiary which constitutes a discontinued operation as defined in SSAP 2 "Net profit or loss for the period, fundamental errors and changes in accounting policies", disclosures are specified by that Statement.

26. A subsidiary is not excluded from consolidation because its business activities are dissimilar from those of the other enterprises within the group. Better information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. For example, the disclosures required by SSAP 26 "Segment reporting" help to explain the significance of different business activities within the group.

### **Specific provisions for Hong Kong incorporated companies**

27. *In preparing consolidated financial statements of a Hong Kong incorporated company, only companies that fall within the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance may be consolidated. Therefore, for the purposes of applying this Statement, Hong Kong incorporated companies should use the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance where it conflicts with the definition in paragraph 8 above.*
28. *In the circumstances where a company is a subsidiary as defined by section 2(4) of the Companies Ordinance but the parent does not have unilateral control over it, it should not be dealt with in the consolidated financial statements as a subsidiary. Where a subsidiary is excluded on the grounds of lack of effective control, it should be accounted for as a jointly controlled entity in accordance with SSAP 21 "Accounting for interests in joint ventures" or an associate in accordance with SSAP 10 "Accounting for investments in associates", as appropriate.*

### **Consolidation procedures**

29. In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries are combined on a line-by-line basis by adding together like items of assets, liabilities, equity, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single enterprise, the following steps are then taken:
- a. the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see SSAP 30 "Business combinations" which also describes the treatment of any resultant goodwill);
  - b. minority interests in the net income of consolidated subsidiaries for the reporting period are identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent; and
  - c. minority interests in the net assets of consolidated subsidiaries are identified and presented in the consolidated balance sheet separately from liabilities and the parent shareholders' equity. Minority interests in the net assets consist of:
    - i. the amount at the date of the original combination calculated in accordance with SSAP 30 "Business combinations"; and
    - ii. the minority's share of movements in equity since the date of the combination.
30. Taxes payable by either the parent or its subsidiaries on distribution to the parent of the profits retained in subsidiaries are accounted for in accordance with SSAP 12 "Accounting for deferred tax".
31. *Intragroup balances and intragroup transactions and resulting unrealised profits should be eliminated in full. Unrealised losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.*

32. Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. Timing differences that arise from the elimination of unrealised profits and losses resulting from intragroup transactions are dealt with in accordance with SSAP 12 "Accounting for deferred tax".
33. ***When the financial statements used in the consolidation are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements. In any case the difference between reporting dates should be no more than three months.***
34. The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements are usually drawn up to the same date. When the reporting dates are different, the subsidiary often prepares, for consolidation purposes, statements as at the same date as the group. When it is impracticable to do this, financial statements drawn up to different reporting dates may be used provided the difference is no greater than three months. The consistency principle dictates that the length of the reporting periods and any difference in the reporting dates should be the same from period to period.
35. ***Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, the reasons should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.***
36. In many cases, if a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.
37. The results of operations of a subsidiary are included in the consolidated financial statements as from the date of acquisition, which is the date on which control of the acquired subsidiary is effectively transferred to the buyer, in accordance with SSAP 30 "Business combinations". The results of operations of a subsidiary disposed of are included in the consolidated income statement until the date of disposal which is the date on which the parent ceases to have control of the subsidiary. The difference between the proceeds from the disposal of the subsidiary and, as of the date of disposal, the total of:
- a. the carrying amount of its assets less liabilities;
  - b. minority interests;
  - c. the related unamortised goodwill; and
  - d. the related accumulated foreign currency translation difference,
- is recognised in the consolidated income statement as the profit or loss on the disposal of the subsidiary. In order to ensure the comparability of the consolidated financial statements from one accounting period to the next, supplementary information is often provided about the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.
38. ***An investment in an enterprise should be accounted for in accordance with SSAP 24 "Accounting for investments in securities" from the date that it ceases to fall within the definition of a subsidiary and does not become a jointly controlled entity as defined in SSAP 21 "Accounting for interests in joint ventures" or an associate as defined in SSAP 10 "Accounting for investments in associates".***
39. The carrying amount of the investment at the date that it ceases to be a subsidiary is regarded as cost thereafter.

40. *Minority interests should be presented in the consolidated balance sheet separately from liabilities and the parent shareholders' equity. Minority interests in the income of the group should also be separately presented.*
41. The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are charged against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, the majority interest is allocated all such profits until the minority's share of losses previously absorbed by the majority has been recovered.
42. If a subsidiary has outstanding cumulative preferred shares which are held outside the group, the parent computes its share of profits or losses after adjusting for the subsidiary's preferred dividends, whether or not dividends have been declared.

### **Accounting for investments in subsidiaries in a parent's separate financial statements**

43. *Subject to paragraph 44, an investment in a subsidiary in a parent's separate financial statements should be either:*
- a. *carried at cost (less any impairment loss); or*
  - b. *accounted for as an investment other than a held-to-maturity security in accordance with SSAP 24 "Accounting for investments in securities".*
44. *Where a subsidiary:*
- a. *is acquired and held exclusively with a view to its subsequent disposal in the near future; or*
  - b. *operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent,*
- it should be accounted for in the separate financial statements of the parent as an investment other than a held-to-maturity security in accordance with SSAP 24 "Accounting for investments in securities".*

### **Disclosure**

45. *In addition to those disclosures required by paragraphs 10 and 35, the following disclosures should be made:*
- a. *in consolidated financial statements a listing of significant subsidiaries including the name, country of incorporation or residence, nature of business, proportion of ownership interest and, if different, proportion of voting power held;*
  - b. *in consolidated financial statements, where applicable:*
    - i. *the reasons for not consolidating a subsidiary, the accounting policy used, the name of the subsidiary excluded and the premium or discount on acquisition (the difference between the purchase consideration and the fair value of assets acquired) to the extent not written off to the income statement;*

- ii. *the net assets of a subsidiary excluded from consolidation on the grounds of severe long-term restrictions, its profit or loss for the period and the amounts included in the consolidated financial statements in respect of dividends and the changes in the carrying amount of such subsidiary;*
  - iii. *the nature of the relationship between the parent and a subsidiary of which the parent does not own, directly or indirectly through subsidiaries, more than one half of the voting power;*
  - iv. *the name of an enterprise in which more than one half of the voting power is owned, directly or indirectly through subsidiaries, but which, because of the absence of control, is not a subsidiary;*
  - v. *the effect of the acquisition of subsidiaries on the financial position at the reporting date and the results for the reporting period;*
  - vi. *the effect of the disposal of subsidiaries on the results for the reporting period and on the corresponding amounts for the preceding period;*
  - vii. *the name and the accounting date of a subsidiary with a different accounting date and the reasons for using such a date;*
  - viii. *the length of the accounting period of a subsidiary that is not the same as that of the parent;*
  - ix. *the extent of the restrictions on the ability of the parent to distribute the retained profits of the group (other than those shown as non-distributable) because of statutory, contractual, exchange control or taxation restrictions; and*
  - x. *the fact if retained profits of overseas subsidiaries would be subject to further tax on distributions; and*
- c. *in the parent's separate financial statements, a description of the method used to account for subsidiaries.*

### **Specific disclosures for Hong Kong incorporated companies**

46. *When a Hong Kong incorporated company holds an enterprise which would be a subsidiary as defined in paragraph 8 but is not accounted for as a subsidiary as a result of paragraph 27, it should disclose in the notes details of the effect on the consolidated financial statements had the exemption given in paragraph 27 not applied.*

### **Effective date**

47. *The accounting practices set out in this Statement should be regarded as standard in respect of financial statements relating to periods beginning on or after 1 January 2001. Earlier adoption is encouraged but not required. If an enterprise applies this Statement for financial statements covering periods beginning before 1 January 2001, the enterprise should:*
- a. *disclose that fact; and*
  - b. *adopt SSAP 30 "Business combinations" at the same time.*
48. This Statement of Standard Accounting Practice replaces SSAP 7 "Group accounts" issued in March 1984 and revised in October 1993.



## Notes on legal requirements in Hong Kong

49. Under section 2(4) of the Companies Ordinance, a company shall be deemed to be a subsidiary of another company, if:
- a. that other company:
    - i. controls the composition of the board of directors of the first mentioned company; or
    - ii. controls more than half of the voting power of the first mentioned company; or
    - iii. holds more than half of the issued share capital of the first mentioned company (excluding any part of it which carries no right to participate beyond a specified amount in a distribution of either profits or capital); or
  - b. the first mentioned company is a subsidiary of any company which is that other company's subsidiary.
50. For the purposes of defining a subsidiary under section 2(4) of the Companies Ordinance, section 2(5) of the Companies Ordinance states that the composition of a company's board of directors shall be deemed to be controlled by another company if that other company by the exercise of some power exercisable by it, without the consent or concurrence of any other person, can appoint or remove all or a majority of the directors, and, for the purposes of this provision, that other company shall be deemed to have power to make such an appointment if:
- a. a person cannot be appointed as a director without the exercise in his favour by that other company of such a power; or
  - b. a person's appointment as a director follows necessarily from his being a director or other officer of that other company.
51. The obligation to lay group accounts before the members of a holding company in general meeting is set out in section 124(1) of the Companies Ordinance. In general terms the form and content of group accounts are dealt with inter alia in sections 125 and 126 of the Companies Ordinance and in the Tenth Schedule to the Companies Ordinance.
52. Under section 124(2)(a) of the Companies Ordinance group accounts shall not be required where the holding company is at the end of its financial year the wholly-owned subsidiary of another body corporate. Paragraph 10 of this Statement encompasses this exemption.
53. Section 124(2)(b) of the Companies Ordinance also allows group accounts (subject to approval of the Financial Secretary in certain instances) not to deal with a subsidiary if the company's directors are of the opinion that:
- a. it is impracticable, or would be of no real value to members of the company, in view of the insignificant amount involved, or would involve expense or delay out of proportion to the value to members of the company; or
  - b. the result would be misleading, or harmful to the business of the company or any of its subsidiaries; or
  - c. the business of the holding company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking.

It should be noted that this Statement takes the view that all subsidiaries should be included in the consolidated financial statements except for those referred to in paragraph 23.

54. In general, the Companies Ordinance requires group accounts to be presented in the form of consolidated accounts and should comprise a consolidated balance sheet and a consolidated profit and loss account dealing with the state of affairs and profit or loss of the company and its subsidiaries. However, the Companies Ordinance also accepts that group accounts may be presented in a form other than a single set of consolidated accounts under certain conditions. It is generally accepted that consolidated financial statements are usually the best means of achieving the objective of giving a true and fair view of the profit or loss and of the state of affairs of the group. It should be noted that, where subsidiaries are not dealt with in group accounts or are being dealt with in a form of group accounts other than consolidated financial statements, information may still be required by law about the results of these subsidiaries and the extent to which they have been dealt with in the accounts of the holding company (paragraphs 18(4) and 24 of the Tenth Schedule to the Companies Ordinance).
55. Section 127(1) of the Companies Ordinance states that a holding company's directors shall secure that, except where in their opinion there are good reasons against it, the financial year of each of its subsidiaries shall coincide with the company's own financial year. Paragraph 33 of this Statement specifies the action to be taken in preparing consolidated accounts where accounting periods do not coincide.
56. Section 126(2) of the Companies Ordinance requires that, if the financial year of a subsidiary is not co-terminous with that of the holding company, the group accounts shall deal with the subsidiary's results and state of affairs as of the last financial year ending on or before the date of the holding company's balance sheet. It also requires the disclosure of the reasons why the financial year of a subsidiary does not coincide with that of the holding company.

### **Compliance with International Accounting Standards**

57. Except for the following, compliance with this Statement ensures compliance, in all material respects, with International Accounting Standard (IAS) 27 "Consolidated financial statements and accounting for investments in subsidiaries":
- a. Due to the legal constraints as mentioned in paragraph 4 of this Statement, paragraph 27 of this Statement recognises that Hong Kong incorporated companies should use the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance where it conflicts with the definition of a subsidiary as stated in paragraph 8 of this Statement.
  - b. IAS 27 allows a parent that is virtually wholly owned, which is often taken to mean that the parent owns 90% or more of the voting power, not to present consolidated financial statements provided that the parent obtains the approval of the owners of the minority interest. No similar exemption is granted under this Statement.
  - c. IAS 27 allows an alternative for an investment in a subsidiary to be accounted for in the parent's separate financial statements using the equity method. However, this alternative treatment is not allowed under this Statement.
  - d. IAS 27 places an investment in a subsidiary that operates under severe long-term restrictions which significantly impair its ability to transfer funds to the investor under IAS 39 "Financial Instruments: Recognition and measurement" and will generally be measured at fair value. However, this Statement places such an investment under SSAP 24 "Accounting for investments in securities". Under the benchmark treatment in SSAP 24, if the investment is classified as an investment security, it will be measured at cost.

## Appendix A

### Indicators of control over an SPE

*The purpose of this appendix is to illustrate the application of the standards to assist in clarifying their meaning.*

The examples in paragraph 21 of this Statement are intended to indicate types of circumstances that should be considered in evaluating a particular arrangement in light of the substance-over-form principle. The guidance provided in this Statement and in this Appendix is not intended to be used as "a comprehensive checklist" of conditions that must be met cumulatively in order to require consolidation of an SPE.

#### (a) *Activities*

The activities of the SPE, in substance, are being conducted on behalf of the reporting enterprise, which directly or indirectly created the SPE according to its specific business needs.

Examples are:

- the SPE is principally engaged in providing a source of long-term capital to an enterprise or funding to support an enterprise's ongoing major or central operations; or
- the SPE provides a supply of goods or services that is consistent with an enterprise's ongoing major or central operations which, without the existence of the SPE, would have to be provided by the enterprise itself.

Economic dependence of an entity on the reporting enterprise (such as relations of suppliers to a significant customer) does not, by itself, lead to control.

#### (b) *Decision-making*

The reporting enterprise, in substance, has the decision-making powers to control or to obtain control of the SPE or its assets, including certain decision-making powers coming into existence after the formation of the SPE. Such decision-making powers may have been delegated by establishing an "autopilot" mechanism.

Examples are:

- power to unilaterally dissolve an SPE;
- power to change the SPE's charter or bylaws; or
- power to veto proposed changes of the SPE's charter or bylaws.

#### (c) *Benefits*

The reporting enterprise, in substance, has rights to obtain a majority of the benefits of the SPE's activities through a statute, contract, agreement, or trust deed, or any other scheme, arrangement or device. Such rights to benefits in the SPE may be indicators of control when they are specified in favour of an enterprise that is engaged in transactions with an SPE and that enterprise stands to gain those benefits from the financial performance of the SPE.

Examples are:

- rights to a majority of any economic benefits distributed by an entity in the form of future net cash flows, earnings, net assets, or other economic benefits; or
- rights to majority residual interests in scheduled residual distributions or in a liquidation of the SPE.

(d) *Risks*

An indication of control may be obtained by evaluating the risks of each party engaging in transactions with an SPE. Frequently, the reporting enterprise guarantees a return or credit protection directly or indirectly through the SPE to outside investors who provide substantially all of the capital to the SPE. As a result of the guarantee, the enterprise retains residual or ownership risks and the investors are, in substance, only lenders because their exposure to gains and losses is limited.

Examples are:

- the capital providers do not have a significant interest in the underlying net assets of the SPE;
- the capital providers do not have rights to the future economic benefits of the SPE;
- the capital providers are not substantively exposed to the inherent risks of the underlying net assets or operations of the SPE; or
- in substance, the capital providers receive mainly consideration equivalent to a lender's return through a debt or equity interest.

## Appendix B

Changes from International Accounting Standard 27 (reformatted 1994) "Consolidated financial statements and accounting for investments in subsidiaries"

*The purpose of this appendix is to summarise the major changes made to the equivalent International Accounting Standard when adopting it in Hong Kong and the reasons for such changes. It does not form part of the standards and should be read in the context of the full text of the Statement.*

Changes	Reasons for the Changes
<p><b>(i) <u>Provisions for Hong Kong incorporated companies</u></b></p> <p>Additional paragraphs are inserted:</p> <ul style="list-style-type: none"> <li>a. to give the background on why Hong Kong incorporated companies should use the definition of subsidiary as set out in section 2(4) of the Companies Ordinance (see paragraphs 3 to 5);</li> <li>b. to include specific provisions for Hong Kong incorporated companies in applying this Statement (see paragraphs 27 and 28); and</li> <li>c. to require specific disclosures for Hong Kong incorporated companies (see paragraph 46).</li> </ul>	<p>This Statement recognises that a Hong Kong incorporated company may not consolidate a company that does not meet the definition of a subsidiary in the Companies Ordinance.</p> <p>This Statement also takes the view that in the circumstances where a company is a subsidiary as defined by the Companies Ordinance but the parent does not have unilateral control over it, it should not be dealt with in the consolidated financial statements as a subsidiary but as a jointly controlled entity.</p>
<p><b>(ii) <u>SSAP 32 Paras 10 to 12 vs IAS 27 Paras 8 to 10</u></b></p> <p>The IAS exemption for a parent that is virtually wholly owned from presenting consolidated financial statements provided that the parent obtains the approval of the owners of the minority interest, and the related guidance, are removed.</p>	<p>To conform with the requirements of the Companies Ordinance which requires the parent to be wholly-owned to be exempted from the requirements to prepare consolidated financial statements.</p>
<p><b>(iii) <u>SSAP 32 Para 15</u></b></p> <p>An additional paragraph is inserted to state that in the case where no single party is in a position to control unilaterally the activity of the investee enterprise, such investee enterprise is to be accounted for as a jointly controlled entity in accordance with SSAP 21 "Accounting for interests in joint ventures" instead of a subsidiary in accordance with this Statement.</p>	<p>For the avoidance of doubt.</p>

<p><b>(iv) <u>SSAP 32 Paras 16 to 22 &amp; Appendix A</u></b></p> <p>The provisions of SIC Interpretation 12 "Consolidation - Special purpose entities" issued by the IASC's Standing Interpretations Committee are added to this Statement.</p>	<p>To bring this Statement fully in line with the IAS.</p>
<p><b>(v) <u>SSAP 32 Paras 23, 38, 43 and 44 vs IAS 27 Paras 13, 24, 29 and 30</u></b></p> <p>All cross-references to the treatments under IAS 39 "Financial instruments: Recognition and measurement" are replaced by cross-references to the treatments under SSAP 24 "Accounting for investments in securities".</p>	<p>SSAP 24 is the SSAP in Hong Kong that is equivalent to IAS 39 as regards accounting for investments in securities.</p>
<p><b>(vi) <u>SSAP 32 Paras 24 and 25</u></b></p> <p>Additional guidance to paragraph 23a of this Statement is added.</p>	<p>To provide additional guidance.</p>
<p><b>(vii) <u>SSAP 32 Para 35 vs IAS 27 Para 21</u></b></p> <p>In the case where it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, this Statement requires the disclosure of the reasons, as opposed to the disclosure of the fact in the IAS, together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.</p>	<p>It is believed that the disclosure of the reasons for not adopting uniform accounting policies is an improved disclosure.</p>
<p><b>(viii) <u>SSAP 32 Para 37 vs IAS 27 Para 23</u></b></p> <p>In addition to the guidance on calculating the profit or loss on the disposal of the subsidiary in the IAS, this Statement specifies that minority interests, the related unamortised goodwill and the related accumulated foreign currency translation difference would also be included in the calculation.</p>	<p>For the avoidance of doubt and to achieve consistency in practice.</p>

<p><b>(ix) <u>SSAP 32 Paras 43 - 45 vs IAS 27 Paras 29-30</u></b></p> <ol style="list-style-type: none"> <li>1. The IAS option to account for an investment in a subsidiary in a parent's separate financial statements using the equity method is removed.</li> <li>2. The IAS option to account for an investment in a subsidiary in a parent's separate financial statements using the cost method is not extended to a temporary subsidiary or a subsidiary that operates under severe long-term restrictions.</li> </ol>	<ol style="list-style-type: none"> <li>1. This Statement takes the view that the inclusion of undistributed profits of other companies would ignore the separate legal status of the entities concerned and, as regards the parent, be contrary to the practice of not taking credit for investment income until it is received or receivable.</li> <li>2. This Statement takes the view that the method of accounting for a temporary subsidiary and for a subsidiary that operates under severe long-term restrictions in the parent's separate financial statements should be consistent with that in the consolidated financial statements.</li> </ol>
<p><b>(x) <u>SSAP 32 Para 45 vs IAS 27 Para 32</u></b></p> <p>Disclosure requirements as regards:</p> <ol style="list-style-type: none"> <li>a. the nature of business of a subsidiary (see paragraph 45(a));</li> <li>b. excluded subsidiaries (see paragraph 45(b)(i)&amp;(ii));</li> <li>c. a subsidiary with a different accounting date (see paragraph 45(b)(vii));</li> <li>d. a subsidiary with an accounting period that is not of the same length as the parent (see paragraph 45(b)(viii));</li> <li>e. restrictions on the ability to distribute the retained profits (see paragraph 45(b)(ix)); and</li> <li>f. retained profits that would be subject to further tax on distribution (see paragraph 45(b)(xi));</li> </ol> <p>are added to this Statement.</p>	<p>Additional disclosures regarded as desirable.</p>